

In the opinion of Bond Counsel, interest on the Series BS Bonds is excluded from gross income for federal income tax purposes, is exempt from State of California personal income taxes and is not treated as a preference item for purposes of calculating the federal individual and corporate alternative minimum taxes; such interest is, however, included in the adjusted current earnings of certain corporations in calculating the alternative minimum tax imposed on such corporations. In the opinion of Bond Counsel delivered on December 1, 1999, interest on the Series BJ Bonds was excluded from gross income for federal income tax purposes, was exempt from the State of California personal income taxes and was a specific preference item for purposes of calculating the federal individual or corporate alternative minimum taxes. In the opinion of Bond Counsel, remarketing of the Series BJ Bonds does not, in and of itself, adversely affect the exclusion of interest thereon from gross income for federal income tax purposes. See "TAX MATTERS" herein.

\$66,500,000

**STATE OF CALIFORNIA
VETERANS GENERAL OBLIGATION BONDS**

Fixed Rate New Issue
\$26,500,000 Series BS (Non-AMT)

Fixed Rate Remarketing
\$40,000,000 Series BJ 9/10 (AMT)

Dated: March 1, 2000
(Interest accruing from March 1, 2000)
Due as shown on inside front cover page

Dated: December 29, 1997
(Interest accruing from December 1, 1999
through April 26, 2000 at 3.20%)
Due as shown on inside front cover page

This offering consists of veterans general obligation bonds listed above (the "Offered Veterans G.O. Bonds") authorized by the voters of the State of California (the "State").

Interest is payable on June 1 and December 1 of each year, commencing as shown on the inside cover page. The Offered Veterans G.O. Bonds may be purchased in book-entry form only, in the principal amount of \$5,000 or any integral multiples thereof. See APPENDIX C—"BOOK-ENTRY SYSTEM." The Offered Veterans G.O. Bonds are subject to redemption prior to maturity, including redemption at par. See "THE OFFERED VETERANS G.O. BONDS—Redemption".

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES AND PRICES OR YIELDS
(see inside front cover page)

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on the Offered Veterans G.O. Bonds are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school systems and public institutions of higher education. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS—Security and Payment of Veterans G.O. Bonds."

This cover page contains certain information for quick reference only. It is not a summary of this issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision.

The Series BS Bonds are offered when, as and if issued and received by the Underwriters set forth below, subject to certain conditions, including the receipt of certain legal opinions of The Honorable Bill Lockyer, Attorney General of the State of California, and of Hawkins, Delafield & Wood, Bond Counsel to the State. In connection with the issuance of the Offered Veterans G.O. Bonds, Public Resources Advisory Group has served as Financial Advisor, Quateman & Zidell LLP has served as Disclosure Counsel to the State and Orrick, Herrington & Sutcliffe LLP has served as Special Counsel to the State regarding Appendix A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP. The remarketing of the Series BJ Bonds by the Underwriters is subject to certain conditions, including receipt of the opinion of Bond Counsel described above. The Offered Veterans G.O. Bonds will be available for delivery on or about April 27, 2000.

Honorable Philip Angelides
Treasurer of the State of California

Merrill Lynch & Co.

Bear, Stearns & Co. Inc.
Banc of America Securities LLC
J.P. Morgan & Co.
Prudential Securities

Fleet Securities, Inc.
Loop Capital Markets, LLC
Sutro & Co. Incorporated

Lehman Brothers
Goldman, Sachs & Co.
Mischler Financial Group, Inc.
Sutter Securities Incorporated

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES AND PRICES OR YIELDS

Fixed Rate New Issue

\$26,500,000 Serial Veterans G.O. Bonds Series BS (Non-AMT)—Dated: March 1, 2000
(Interest accruing from March 1, 2000)

<u>Maturity Date (December 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>CUSIP Number</u>
2004	\$ 100,000	4.50%	130629VX3
2005	6,900,000	4.60	130629VY1
2006	7,500,000	4.65	130629VZ8
2007	7,000,000	4.70	130629WA2
2008	5,000,000	4.80	130629WB0

First interest payment date: June 1, 2000

Fixed Rate Remarketing

\$40,000,000 Veterans G.O. Bonds Series BJ 9/10 (AMT)—Dated: December 29, 1997
(Interest accruing from December 1, 1999 through April 26, 2000 at 3.20% and
thereafter at the rates set forth below)

\$6,550,000 Serial Veterans G.O. Bonds Series BJ 9/10

<u>Maturity Date (December 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>CUSIP Number</u>	<u>Maturity Date (December 1)</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>CUSIP Number</u>
2002	\$10,000	4.55%	130629VD7	2010	\$ 10,000	5.10%	130629VM7
2003	10,000	4.65	130629VE5	2011	860,000	5.20	130629VN5
2004	10,000	4.70	130629VF2	2012	995,000	5.30	130629VP0
2005	10,000	4.75	130629VG0	2013	1,055,000	5.35	130629VQ8
2006	10,000	4.80	130629VH8	2014	1,115,000	5.45	130629VR6
2007	10,000	4.875	130629VJ4	2015	1,185,000	5.55	130629VS4
2008	10,000	4.95	130629VK1	2016	1,250,000	5.60	130629VT2
2009	10,000	5.00	130629VL9				

\$2,730,000 5.80% Term Veterans G.O. Bonds Series BJ 9/10 due December 1, 2018, CUSIP No. 130629VU9

\$10,275,000 6.00% Term Veterans G.O. Bonds Series BJ 9/10 due December 1, 2024, CUSIP No. 130629VV7

\$20,445,000 6.05% Term Veterans G.O. Bonds Series BJ 9/10 due December 1, 2032, CUSIP No. 130629VW5

First interest payment date: June 1, 2000

Price of all Offered Veterans G.O. Bonds: 100% plus accrued interest

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Copies of this Official Statement may be obtained from:

HONORABLE PHILIP ANGELIDES

Treasurer of the State of California

P.O. Box 942809

Sacramento, California 94209-0001

(800) 900-3873

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OFFICIAL STATEMENT

\$66,500,000

STATE OF CALIFORNIA

VETERANS GENERAL OBLIGATION BONDS

Fixed Rate New Issue

\$26,500,000 Series BS (Non-AMT)

Remarketing

\$40,000,000 Series BJ 9/10 (AMT)

INTRODUCTION

This introduction is a brief summary of the terms of the State of California Veterans General Obligation Bonds listed above (the "Offered Veterans G.O. Bonds") and a brief description of the Official Statement; a full review should be made of the entire Official Statement. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. Summaries of provisions of the Constitution and other laws of the State of California or of any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.

Description of the Offered Veterans G.O. Bonds

The issuance of veterans general obligation bonds ("Veterans G.O. Bonds") is authorized by Bond Acts (defined below) approved by the voters of the State of California (the "State") and by resolutions of the Veterans Finance Committee of 1943. The Offered Veterans G.O. Bonds are authorized by specific Bond Acts and have been issued or are being issued to finance or refinance obligations issued to provide funds for the financing of the purchase of homes and farms for California military veterans under the Farm and Home Purchase Program (the "Program") of the State Department of Veterans Affairs (the "Department"). The Series BS Bonds (the "Series BS Bonds") are being issued for the purpose of replacing and refunding \$26,500,000 aggregate principal amount of Veterans G.O. Bonds. The Series BJ 9/10 Bonds (the "Series BJ Bonds") being remarketed are a portion of the State of California Veterans General Obligation Bonds, Series BJ 3/4 (the "Series BJ 3/4 Bonds") issued in April 1999 as a remarketing of Series BJ 1/2 originally issued in December 1997. \$60,000,000 aggregate principal amount of the Series BJ 3/4 Bonds was remarketed as Series BJ 7/8 Bonds in December 1999 with fixed interest rates to their respective maturities to new Bondholders. The Series BJ Bonds represent the balance of the Series BJ 3/4 Bonds and are being remarketed with fixed interest rates to their respective maturities to new Bondholders in connection with a mandatory tender on April 27, 2000 by existing Bondholders. See "THE OFFERED VETERANS G.O. BONDS – Identification and Authorization of the Offered Veterans G.O. Bonds."

The Offered Veterans G.O. Bonds will be registered in the name of a nominee of The Depository Trust Company ("DTC") which will act as securities depository for the Offered Veterans G.O. Bonds. Purchases of beneficial interests in the Offered Veterans G.O. Bonds may be in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. Principal and interest are payable as specified on the front cover page and inside front cover page of this Official Statement.

Security and Sources of Payment for Veterans G.O. Bonds

The Offered Veterans G.O. Bonds are general obligations of the State to which the full faith and credit of the State are pledged (see "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security and Payment of Veterans G.O. Bonds" below). Principal of and interest on the Veterans G.O. Bonds are payable from moneys in the General Fund of the State Treasury (the "General Fund") (see APPENDIX A – "THE STATE OF CALIFORNIA – State Finances – The General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. The Bond Acts authorizing the Offered Veterans G.O. Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Offered Veterans G.O. Bonds. State law requires funds for the payment of debt service on the Offered Veterans G.O. Bonds to be transferred to the General Fund from the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund"). See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security and Payment of Veterans G.O. Bonds" and APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND."

Redemption

The Offered Veterans G.O. Bonds are subject to optional and special redemption prior to maturity. In addition, the Series BJ Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032, respectively, are subject to mandatory redemption at par prior to their stated maturities, in part, from sinking fund payments made by the State. See "THE OFFERED VETERANS G.O. BONDS – Redemption."

Information Related to this Official Statement

The information set forth herein has been obtained from official sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State or the Department since the date hereof.

All financial and other information presented in this Official Statement has been provided by, respectively, the State or the Department from its records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of, respectively, the State or the Department. No representation is made that past experience, as it might be shown by financial and other information, will necessarily continue or be repeated in the future.

This Official Statement is not to be construed as a contract with the purchasers of the Offered Veterans G.O. Bonds. Statements contained in this Official Statement which involve

estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of facts.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Offered Veterans G.O. Bonds, by any person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State.

IN CONNECTION WITH THIS OFFERING THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE OFFERED VETERANS G.O. BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Tax Matters

In the opinion of Hawkins, Delafield & Wood, Bond Counsel to the State ("Bond Counsel"), under existing statutes and court decisions, assuming compliance by the State and the Department with certain tax covenants described herein, (i) the interest on the Series BS Bonds is not included in gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended, and such interest is exempt from personal income taxes of the State of California under present State law and (ii) the interest on the Series BS Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Internal Revenue Code of 1986, as amended, with respect to individuals and corporations; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations.

Bond Counsel previously rendered to the State Treasurer on December 1, 1999 its opinion that, under then-existing statutes and court decisions, assuming compliance by the State and the Department with certain tax covenants described herein, (i) the interest on the Series BJ Bonds was not included in gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended, and such interest was exempt from personal income taxes of the State of California under State law current on the date of such opinion and (ii) the interest on the Series BJ Bonds was treated as a specific preference item for purposes of calculating the alternative minimum tax imposed under the Internal Revenue Code of 1986, as amended, with respect to individuals and corporations. It is a condition to the remarketing of the Series BJ Bonds that Bond Counsel deliver its opinion that the remarketing of the Series BJ Bonds does not, in and of itself, adversely affect the exclusion of interest on the Series BJ Bonds from gross income for federal income tax purposes. See "TAX MATTERS" below, APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS" and APPENDIX G – "LEGAL OPINIONS OF BOND COUNSEL."

Continuing Disclosure

The State Treasurer, on behalf of the State, will provide annually to certain nationally recognized municipal securities information repositories certain financial information and operating data relating to the State for each Fiscal Year in which any Offered Veterans G.O. Bonds are outstanding (the "Treasurer's Annual Report"), by not later than April 1 of the calendar year following the end of such Fiscal Year, commencing with the report for the 1999-2000 Fiscal Year, and to provide notices of the occurrence of certain other enumerated events if material. The Secretary of the Department will provide annually to certain nationally recognized municipal securities information repositories certain financial information and operating data relating to the Program for each Fiscal Year in which any Offered Veterans G.O. Bonds are outstanding (the "Department's Annual Report"), by not later than April 1 of the calendar year following the end of such Fiscal Year, commencing with the report for the 1999-2000 Fiscal Year. The specific nature of the information to be contained in the Treasurer's Annual Report and the Department's Annual Report or the notices of material events and certain other terms of the continuing disclosure obligations are summarized below under APPENDIX D – "SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES."

Neither the State Treasurer nor the Secretary of the Department has failed to comply, in any material respect, with any "previous undertakings," as that term is used in Rule 15c2-12 promulgated under the Securities Exchange Act of 1934, as amended.

Additional Information

Questions regarding this Official Statement and the issuance of these securities may be addressed to the office of the Honorable Philip Angelides, Treasurer of the State of California, P.O. Box 942809, Sacramento, California 94209-0001, telephone (800) 900-3873. Questions regarding the Program should be addressed to the Bond Finance Division of the Department of Veterans Affairs, P.O. Box 942895, Sacramento, California 94295-0001, telephone (916) 653-2081.

AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS

Authorization

Each general obligation bond act authorizing the issuance of Veterans G.O. Bonds (each, a "Bond Act") incorporates by reference the State General Obligation Bond Law (the "Law"), which is set forth in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides a procedure for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds.

Security and Payment of Veterans G.O. Bonds

The Veterans G.O. Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The full faith and credit of the State are pledged for the punctual payment of principal of and interest on the Veterans G.O. Bonds. The Bond Acts provide that the State shall collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Veterans G.O. Bonds. Each Bond Act also contains a continuing appropriation from the General Fund of the sum annually necessary to pay principal of and interest on the Veterans G.O. Bonds. Payment of principal, premium, if any, and interest on the Veterans G.O. Bonds from the General Fund is subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education.

The Department's principal fund is the 1943 Fund described in APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – The 1943 Fund." The Military and Veterans Code of the State (the "Veterans Code"), of which the Bond Acts are a part, requires that on the dates when funds are to be remitted to bondowners for the payment of debt service on Veterans G.O. Bonds in each fiscal year, there shall be transferred to the General Fund to pay the debt service on Veterans G.O. Bonds all of the money in the 1943 Fund (but not in excess of the amount of debt service then due and payable). If the money so transferred on the remittance dates is less than the debt service then due and payable, the balance remaining unpaid is required by the Veterans Code to be transferred to the General Fund out of the 1943 Fund as soon as it shall become available, together with interest thereon from the remittance date until paid, at the same rate of interest as borne by the applicable Veterans G.O. Bonds, compounded semiannually.

The Veterans Code does not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds. As of December 31, 1999, there were outstanding \$2,636,235,000 aggregate principal amount of Veterans G.O. Bonds. Outstanding home purchase revenue bonds in the aggregate principal amount of \$395,655,000 (as of December 31, 1999) previously issued by the Department, plus revenue bonds scheduled to be issued on March 29, 2000, May 3, 2000 and July 6, 2000 and any additional home purchase revenue bonds issued by the Department in the future (collectively, the "Revenue Bonds") are and will be special obligations of the Department payable solely from, and secured by a pledge of, an undivided interest in the assets of the 1943 Fund (other than proceeds of Veterans G.O. Bonds or any amounts in any rebate account) and any reserve accounts established for the benefit of Revenue Bonds. The Veterans Code provides that this undivided interest in the 1943 Fund is secondary and subordinate to any interest or right in the assets of the 1943 Fund of the people of the State and of the holders of the Veterans G.O. Bonds (that is, the right to payment or reimbursements of debt service on Veterans G.O. Bonds described in the preceding paragraph). If debt service payments to the General Fund are current and all reimbursement of debt service payments with interest as described in the preceding paragraph has been made, no holder or beneficial owner of Veterans G.O. Bonds has any right to restrict disbursements by the Department from the 1943 Fund for any lawful purpose, including payment of debt service on or redemptions and purchases of Revenue Bonds.

While the Department's 1998 Financial Statement for the 1943 Fund reflected an increase in retained earnings, the Department's 1999 Financial Statement for the 1943 Fund reflected a loss in retained earnings. In addition, the Program has experienced significant losses during other recent fiscal years, which have caused decreases in the retained earnings in the 1943 Fund. The Program has been, and currently is, the subject of reviews by the executive and legislative branches of State government. The focus of these reviews has been various public policy concerns relating to the Program, including whether new loan originations under the Program should be terminated and how funds generated by the Program should be applied. The Department does not believe that either termination of the loan originations or use of the Department's moneys to fund other programs, if either or both of these policies were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds.

For additional information, see APPENDIX B - THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – The 1943 Fund" and Exhibit 1 to APPENDIX B – "Department Audited Financial Statements."

THE OFFERED VETERANS G.O. BONDS

General

The Offered Veterans G.O. Bonds are or will be registered in the name of the nominee of The Depository Trust Company ("DTC"), which will act as securities depository for the Offered Veterans G.O. Bonds. Purchases of beneficial interests in the Offered Veterans G.O. Bonds may be made in book-entry form only, in the principal amount of \$5,000 or any integral multiple thereof. See APPENDIX C – "BOOK-ENTRY SYSTEM."

The Offered Veterans G.O. Bonds are or will be dated the applicable dates and will mature on the dates and in the amounts set forth on the inside front cover page hereof. Interest on the Series BJ Bonds will accrue from December 1, 1999 through April 26, 2000 at the annual interest rate in effect prior to the remarketing, *i.e.*, 3.20%, and on and after April 27, 2000 at the respective rates shown on the inside front cover page of this Official Statement; and interest on the Series BS Bonds will accrue from March 1, 2000 at the respective rates shown on the inside front cover page of this Official Statement. Interest on the Offered Veterans G.O. Bonds is payable on June 1 and December 1 in each year (each, an "Interest Payment Date") commencing on June 1, 2000 and shall be calculated on the basis of a 360-day year comprised of twelve thirty-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the participants in DTC for disbursements to the beneficial owners of the Offered Veterans G.O. Bonds. The record date for the payment of interest on the Offered Veterans G.O. Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the day is a business day.

Purpose

Under the Program, the Department acquires residential property to be sold to eligible veterans under contracts of purchase between the Department and such veterans ("Contracts of Purchase"). Such acquisition is financed principally with the proceeds of Veterans G.O. Bonds and the Department's Revenue Bonds. The issuance of the Series BS Bonds is for the purpose of replacing and refunding \$26,500,000 aggregate principal amount of outstanding Veterans G.O. Bonds. The issuance of the Series BS Bonds and certain federal tax-related reallocations are expected to result in approximately \$26,500,000 becoming available for new Contracts of Purchase.

The Series BJ 9/10 Bonds being remarketed are a portion of the State of California Veterans General Obligation Bonds, Series BJ 3/4 issued in April 1999 as a remarketing of Series BJ 1/2 originally issued in December 1997. \$60,000,000 aggregate principal amount of the Series BJ 3/4 Bonds was remarketed as Series BJ 7/8 Bonds in December 1999 with fixed interest rates to their respective maturities to new Bondholders. The Series BJ Bonds represent the balance of the Series BJ 3/4 Bonds, which currently bear interest at a short-term rate and are subject to mandatory tender on April 27, 2000. Upon remarketing, each such remarketed Series BJ Bond will bear interest at a fixed interest rate to its respective stated maturity or earlier redemption.

The proceeds of the remarketed Series BJ Bonds will become available to finance new Contracts of Purchase. These available moneys will be in addition to moneys also made available to finance new Contracts of Purchase through the issuance of the Department's Revenue Bonds and other Veterans G.O. Bonds in 1997, 1998, 1999 and 2000. The Department expects to issue approximately \$160 million principal amount of Revenue Bonds during the first six months of year 2000. See APPENDIX B – DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – Exhibit 2 – Certain Department Financial Information and Operating Data – Contracts of Purchase – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

Identification and Authorization of the Offered Veterans G.O. Bonds

The Series BJ Bonds were issued under two Bond Acts, each authorized by the voters, as described below, for the purpose of financing new Contracts of Purchase when the short-term interest rate borne by such bonds is adjusted to fixed interest rates to maturity. The Series BS Bonds are issued under one Bond Act, authorized by the voters, as described below. See APPENDIX A – "THE STATE OF CALIFORNIA – State Indebtedness." The Series BS Bonds are being issued for the purpose of replacing available moneys to be used to pay the principal amount of certain outstanding Veterans G.O. Bonds becoming due at maturity.

Authorization

\$9,280,000 principal amount of Veterans General Obligation Bonds, Series BJ9, authorized under the Veterans Bond Act of 1988;

\$30,720,000 principal amount of Veterans General Obligation Bonds, Series BJ10, authorized under the Veterans Bond Act of 1990; and

\$26,500,000 principal amount of Veterans General Obligation Bonds, Series BS1, authorized under the Veterans Bond Act of 1980.

Redemption

Sinking Fund Redemption

The Series BJ Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032, respectively (the "Term Bonds") are subject to redemption prior to their respective stated maturity dates, in part, by lot, from sinking fund payments, at a redemption price of 100 percent of the principal amount thereof, plus accrued interest to the date fixed for redemption, without premium, on the respective dates and in the respective amounts shown below.

SINKING FUND REDEMPTION SCHEDULE

<u>Date</u> <u>December 1</u>	<u>Series BJ</u> <u>Bonds Maturing</u> <u>December 1, 2018</u>	<u>Series BJ</u> <u>Bonds Maturing</u> <u>December 1, 2024</u>	<u>Series BJ</u> <u>Bonds Maturing</u> <u>December 1, 2032</u>
2017	\$1,325,000		
2018	1,405,000†		
2019		\$1,480,000	
2020		1,565,000	
2021		1,660,000	
2022		1,755,000	
2023		1,850,000	
2024		1,965,000†	
2025			\$2,080,000
2026			2,200,000
2027			2,330,000
2028			2,460,000
2029			2,610,000
2030			2,760,000
2031			2,920,000
2032			3,085,000†

† Maturity

If less than all of the Term Bonds of the same maturity date are purchased or called for redemption (other than in satisfaction of sinking fund payments), the State Treasurer will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining sinking fund payments relating to such Term Bonds (including the principal amounts due on the respective maturity dates, as shown above), as requested by the Department.

Optional Redemption

The Series BJ Bonds maturing on December 1 of the years 2010 through and including 2016 are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each

maturity), on any date on or after April 27, 2010 at the redemption prices stated below, plus accrued interest to the date fixed for redemption:

<u>Redemption Dates</u> <u>(both dates inclusive)</u>	<u>Redemption Price</u> <u>(as percentage of principal amount redeemed)</u>
April 27, 2010 to April 26, 2011	101%
April 27, 2011 and thereafter	100%

The Term Bonds (those Series BJ Bonds maturing on December 1 of the years 2018, 2024 and 2032, respectively) are subject to optional redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, in whole or in part (of any maturity and by lot within each maturity), on any date on or after April 27, 2006 at the redemption prices stated below, plus accrued interest to the date fixed for redemption:

<u>Redemption Dates</u> <u>(both dates inclusive)</u>	<u>Redemption Price</u> <u>(as percentage of principal amount redeemed)</u>
April 27, 2006 to April 26, 2007	102%
April 27, 2007 to April 26, 2008	101%
April 27, 2008 and thereafter	100%

The Series BS Bonds are not subject to optional redemption prior to their respective stated maturity dates.

Special Redemption from Unexpended Proceeds and Excess Revenues

The Offered Veterans G.O. Bonds are also subject to special redemption prior to their respective stated maturity dates, at the option of the State upon request of the Department, from (i) moneys deposited in the related Series Proceeds Subaccount with respect to the Offered Veterans G.O. Bonds on the date of issuance of such bonds that have not been applied to finance Contracts of Purchase and (ii) Excess Revenues (as defined below) derived from any Veterans G.O. Bonds or any Revenue Bonds. Any such redemption may be on any date, in whole or in part (and of any maturity at the option of the State upon request of the Department and by lot within such maturity), at the principal amount thereof plus accrued interest to the date fixed for redemption, without premium.

Moneys are currently available through the issuance of Veterans G.O. Bonds and Revenue Bonds to finance Contracts of Purchase, and additional moneys may become available to finance Contracts of Purchase through the future issuances of Revenue Bonds and Veterans G.O. Bonds. Since the Department has full discretion, subject to eligibility requirements and the requirements of the Internal Revenue Code of 1954, as amended, or the Internal Revenue Code of 1986, as amended, as applicable (collectively, the "Federal Tax Code"), in applying the proceeds of all of these bonds to finance the Program, the proceeds of prior and future bonds may be used to finance Contracts of Purchase before proceeds of the Offered Veterans G.O. Bonds.

Although the Department's goal is to use moneys made available through the issuance of the Offered Veterans G.O. Bonds (including recycled prepayments) to finance Contracts of Purchase, such expectation is subject to change, and such moneys or prepayments would then be available to redeem Offered Veterans G.O. Bonds, other Veterans G.O. Bonds, and Revenue Bonds. See "THE OFFERED VETERANS G.O. BONDS – Purpose."

Excess Revenues can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase. All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, to pay for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds, to pay Program and Department expenses, and to pay certain insurance claims. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department's decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or for any other permitted purpose depends on many factors, including applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings and Federal Tax Code requirements.

Certain of the outstanding Veterans G.O. Bonds are not subject to redemption prior to maturity. See Exhibit 2 to APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – Certain Department Financial Information and Operating Data."

"Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – The 1943 Fund – Excess Revenues."

Notice of Redemption

When redemption is required while the Offered Veterans G.O. Bonds are in book-entry only form, the State Treasurer shall give notice of redemption by mailing copies of such notice only to DTC (not to the beneficial owners of the Offered Veterans G.O. Bonds) not less than thirty or more than sixty days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the beneficial owners of the Offered Veterans G.O. Bonds. See APPENDIX C – "BOOK-ENTRY SYSTEM." The notice will state, among other things, that the Offered Veterans G.O. Bonds or a designated portion thereof (in the case of redemption of an Offered Veterans G.O. Bond in part but not in whole) are to be redeemed, the dated date of the Offered Veterans G.O. Bonds, the redemption date, the Series and maturities of the Offered Veterans G.O. Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption, no further interest will accrue on the principal of any Offered Veterans G.O. Bonds called for redemption. Notice of redemption will also be provided by mail to certain financial services and securities depository services.

New York Stock Exchange Listing

The State Treasurer expects to list the Term Bonds maturing on December 1, 2024 and December 1, 2032 on the New York Stock Exchange. There can be no assurance that such Term Bonds will be listed or will continue to be listed for the duration of the time they will be outstanding.

TAX MATTERS

Federal Tax Matters

The Series BJ Bonds are part of a single issue for federal income tax purposes with certain outstanding Veterans G.O. Bonds and Revenue Bonds issued in 1997 and 1998 (the "1997/1998 Tax Plan Bonds"). The requirements of applicable federal tax law must be satisfied with respect to the Series BJ Bonds and all such other outstanding Veterans G.O. Bonds and Revenue Bonds in order that interest on the Series BJ Bonds not be included in gross income for federal income tax purposes retroactive to the date of issuance thereof. The requirements of applicable federal tax law must also be separately satisfied with respect to the Series BS Bonds in order that interest on the Series BS Bonds not be included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Requirements Imposed on the Offered Veterans G.O. Bonds by the Federal Tax Code

The Federal Tax Code contains the following loan eligibility requirements which are applicable (with certain exceptions), in whole or in part, to Contracts of Purchase (or portions of Contracts of Purchase) entered into with respect to properties acquired with amounts allocable to qualified veterans' mortgage bonds and/or to qualified mortgage bonds. The Series BJ Bonds and the other 1997/1998 Tax Plan Bonds that are Veterans G.O. Bonds, and the Series BS Bonds, are qualified veterans' mortgage bonds and not qualified mortgage bonds, and the Revenue Bonds that are 1997/1998 Tax Plan Bonds are qualified mortgage bonds and not qualified veterans' mortgage bonds.

The first general requirement of the Federal Tax Code which is applicable to qualified veterans' mortgage bonds is that the aggregate amount that may be issued must not exceed the volume limit based upon statutory formula. The Offered Veterans G.O. Bonds are in compliance with such requirement. An annual volume limit is also imposed on the issuance of qualified mortgage bonds.

The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds, as defined in Appendix E) and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of

excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

The Federal Tax Code states that an issuer will be treated as meeting the arbitrage restrictions on mortgage loans if it in good faith attempted to meet such requirement and any failure to meet such requirement was due to inadvertent error after taking all reasonable steps to comply with such requirement. See APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS."

Opinions of Bond Counsel

In the opinion of Bond Counsel (expected to be delivered in substantially the form set forth in Appendix G), under existing statutes and court decisions, (i) interest on the Series BS Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended, and (ii) interest on the Series BS Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Internal Revenue Code of 1986, as amended, with respect to individuals and corporations; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the minimum tax imposed on such corporations.

Bond Counsel previously delivered to the State Treasurer on December 1, 1999 its opinion (the form of which is appended hereto in Appendix G) that under then-existing statutes and court decisions, (i) interest on the Series BJ Bonds was excluded from gross income for federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended and (ii) interest on the Series BJ Bonds was a specific preference item for purposes of calculating the federal individual and corporate alternative minimum taxes. It is a condition to the remarketing of the Series BJ Bonds that Bond Counsel deliver its opinion (the proposed form of which is included in Appendix G hereto) that the remarketing of the Series BJ Bonds does not, in and of itself, adversely affect the exclusion of interest on the Series BJ Bonds from gross income for federal income tax purposes.

In rendering the foregoing opinions, Bond Counsel has assumed and assumes compliance by the State and the Department with and enforcement by the State and the Department of the documents authorizing the issuance of the 1997/1998 Tax Plan Bonds and the applicable Program Documents. Bond Counsel has expressed and expresses no opinion as to the exclusion from gross income of interest on any Offered Veterans G.O. Bonds subsequent to any date on which action is taken pursuant to (i) with respect to the Series BJ Bonds, the documents authorizing the issuance of the 1997/1998 Tax Plan Bonds, and (ii) with respect to the Series BS Bonds, the documents authorizing the issuance of the Series BS Bonds, for which action such documents related to such respective Series require a legal opinion to the effect that taking such action will not adversely affect such exclusion, unless such firm delivers an opinion as of such date to such effect.

Certain Additional Federal Tax Consequences

The following is a brief discussion of certain federal income tax matters with respect to the Offered Veterans G.O. Bonds under existing statutes. It does not purport to deal with all aspects of federal taxation that may be relevant to a particular owner of an Offered Veterans G.O. Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the federal tax consequences of owning and disposing of the Offered Veterans G.O. Bonds.

As noted above, interest on the Series BJ Bonds is, and interest on the Series BS Bonds is not, a preference item in determining the tax liability of individuals, corporations, and other taxpayers subject to the alternative minimum tax imposed by Section 55 of the Internal Revenue Code of 1986, as amended. Interest on the Offered Veterans G.O. Bonds must also be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Internal Revenue Code of 1986, as amended.

Owners of Offered Veterans G.O. Bonds should be aware that the ownership of such obligations may result in collateral federal income tax consequences to various categories of persons, such as corporations (including S corporations and certain foreign corporations), financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, and individuals otherwise eligible for the earned income tax credit and to taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is not included in gross income for federal income tax purposes.

Legislation affecting municipal bonds is frequently considered by the United States Congress. There can be no assurance that legislation enacted or proposed after the date of issuance of the Offered Veterans G.O. Bonds will not have an adverse effect on the tax-exempt status or market price of the Offered Veterans G.O. Bonds.

State Tax Matters

In the opinion of Bond Counsel rendered with respect to the Series BJ Bonds on December 1, 1999, and to be rendered with respect to the Series BS Bonds on the date of delivery thereof, interest on the Offered Veterans G.O. Bonds is exempt from personal income taxes of the State of California under State law in effect on the respective dates of such opinions. Complete copies of the opinion previously rendered with respect to the Series BJ Bonds and the proposed form of opinion to be rendered with respect to the Series BS Bonds are contained in Appendix G.

LEGAL OPINIONS

The then-Attorney General of the State of California rendered an approving opinion as to the validity of the Series BJ Bonds on December 29, 1997, to the effect that the State had lawful authority for the issuance of Series BJ Bonds, that the Series BJ Bonds constituted the valid and legally binding general obligations of the State payable from the General Fund of the State and that the full faith and credit of the State are pledged to the punctual payment of principal of and

interest on the Series BJ Bonds. The proposed form of the opinion of The Honorable Bill Lockyer, Attorney General of the State of California, as to the validity of the Series BS Bonds, is included in Appendix F. The opinion of Bond Counsel as to the validity of the Series BJ Bonds and treatment of interest thereon for federal income tax purposes which was rendered on December 1, 1999, the proposed form of the opinion of Bond Counsel as to the effect of the remarketing of the Series BJ Bonds on such treatment of interest for federal income tax purposes and the proposed form of the opinion of Bond Counsel as to the validity of the Series BS Bonds and treatment of interest thereon for federal income tax purposes, are included in Appendix G.

The Attorney General and Bond Counsel undertake no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed upon by Quateman & Zidell LLP, Disclosure Counsel to the State and by Orrick, Herrington & Sutcliffe LLP, Special Counsel to the State regarding Appendix A. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP.

LITIGATION

There is not now pending or known to the Attorney General to be threatened any material litigation seeking to prevent the remarketing or sale and delivery of the Offered Veterans G.O. Bonds or questioning the validity of the Offered Veterans G.O. Bonds. As stated above, debt service on the Veterans G.O. Bonds is a continuing appropriation in the Bond Acts. See "AUTHORIZATION OF AND SECURITY FOR THE OFFERED VETERANS G.O. BONDS – Security and Payment of Veterans G.O. Bonds." In June 1998, a complaint was filed in Los Angeles County Superior Court in the case of *Howard Jarvis Taxpayers Association v. Connell* challenging the authority of the State Controller to make payments in the absence of a State budget. The lawsuit did not specifically attack the validity of the law or the continuing appropriations under the Bond Acts. The Superior Court judge, however, issued a preliminary injunction preventing the State Controller from making payments, including those made pursuant to continuing appropriations, while the State's annual budget act had not yet been enacted. As permitted by the State Constitution, the State Legislature immediately enacted and the Governor of the State signed, an emergency appropriations bill which allowed continued payment of various State obligations, including debt service. Subsequently, the State Legislature enacted and the Governor of the State signed the budget act for the 1998-99 fiscal year. See APPENDIX A – "THE STATE OF CALIFORNIA – Litigation" for more information about the status of this case.

The Attorney General and Bond Counsel have rendered an opinion that the conclusion of the Superior Court judge in the *Jarvis* case (which is now stayed pending appeal) questioning the validity of continuing appropriations, if and to the extent it would apply to the Offered Veterans G.O. Bonds, is without merit and that the California appellate courts would hold that the appropriations are valid under the State Constitution and that the State Controller may make payments pursuant to such appropriations. While there can be no assurance as to the outcome of the litigation, the State believes that moneys will be available in due course on a timely basis to make all future payments of debt service on the Offered Veterans G.O. Bonds.

While at any given time, including the present, there are numerous civil actions pending against the State, which could, if determined adversely to the State, affect the State's expenditures

and, in some cases, its revenues, the Attorney General is of the opinion that no pending actions are likely to have a material adverse effect on the State's ability to pay principal and purchase price of, premium, if any, and interest on the Offered Veterans G.O. Bonds when due.

See APPENDIX A – "THE STATE OF CALIFORNIA – Litigation." See APPENDIX B – "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – The 1943 Fund" for a discussion of certain litigation which may affect the 1943 Fund.

UNDERWRITING

The Offered Veterans G.O. Bonds are being purchased by the Underwriters listed on the front cover page. The Underwriters have jointly and severally agreed to purchase the Offered Veterans G.O. Bonds for a purchase price of (i) \$26,500,000 plus accrued interest, with respect to the Series BS Bonds and (ii) par, plus accrued interest (including interest accrued from December 1, 1999 through April 26, 2000), with respect to the Series BJ Bonds. In connection therewith the Department will pay a fee to the Underwriters of (i) \$214,385.65 with respect to the Series BS Bonds and (ii) \$365,564.65 with respect to the Series BJ Bonds. The initial public offering prices of the Offered Veterans G.O. Bonds may be changed from time to time by the Underwriters.

The purchase contract relating to the Offered Veterans G.O. Bonds provides that the Underwriters will purchase all the applicable Offered Veterans G.O. Bonds if any are purchased, and that the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") are attached for the Fiscal Year ended June 30, 1999. See APPENDIX A – "THE STATE OF CALIFORNIA – Financial Statements".

Certain unaudited financial information for the period from July 1, 1999 through December 31, 1999 is included as an Exhibit to Appendix A. See APPENDIX A – "Exhibit 2 – State Controller's Statement of General Fund Cash Receipts and Disbursements, July 1, 1999 – December 31, 1999."

INDEPENDENT AUDITORS

Attached as Exhibit 1 to Appendix B are the Financial Statements for the Veterans Farm and Home Building Fund of 1943 for the years ended June 30, 1999 and 1998. These statements have been audited by Deloitte & Touche LLP, independent auditors, as indicated in their report appearing in Appendix B.

RATINGS

The Offered Veterans G.O. Bonds have received ratings of "Aa3" by Moody's Investors Service ("Moody's"), "AA-" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P") and "AA" by Fitch IBCA, Inc. ("Fitch"). An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies, if in their respective judgments, circumstances so warrant. A revision or withdrawal of any such credit ratings could have an effect on the market price of the applicable Offered Veterans G.O. Bonds. After the Offered Veterans G.O. Bonds are rated, the State Treasurer intends to provide appropriate periodic credit information to the bond rating agencies to assist in maintaining the ratings on the Offered Veterans G.O. Bonds.

ADDITIONAL INFORMATION

The purpose of this Official Statement is to supply information to prospective buyers of the Offered Veterans G.O. Bonds. Public Resources Advisory Group has served as Financial Advisor in connection with the issuance of the Offered Veterans G.O. Bonds.

All financial and statistical data contained herein have been taken or constructed from State (including Department) records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State, including the Department. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. Any statements made in this Official Statement involving matters of opinion, projections or estimates, whether expressly stated or not, are set forth as such and not as representations of fact.

STATE OF CALIFORNIA

By: /s/ Philip Angelides
Treasurer of the State of California

APPENDIX A

THE STATE OF CALIFORNIA



Honorable Philip Angelides
Treasurer of the State of California

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OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amendments to the Constitution and local government charters. In addition, the State voters may directly influence State government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on State finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, has annually issued an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles.

The Governor is the chief executive officer of the State and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, State law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected, are as follows:

<u>Office</u>	<u>Name</u>	<u>Party Affiliation</u>	<u>First Elected</u>
Governor.....	Gray Davis	Democrat	1998
Lieutenant Governor.....	Cruz Bustamante	Democrat	1998
Treasurer.....	Philip Angelides	Democrat	1998
Attorney General	Bill Lockyer	Democrat	1998
Controller	Kathleen Connell	Democrat	1994
Secretary of State.....	Bill Jones	Republican	1994
Superintendent of Public Instruction.	Delaine Eastin	Democrat	1994
Insurance Commissioner.....	Chuck Quackenbush	Republican	1994

The current term for each office expires in January 2003. Persons elected to statewide offices are limited to two terms in office.

The executive branch is principally administered through thirteen major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Department of Industrial Relations, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs, Trade and Commerce Agency, and Youth and Adult Correctional Agency. In addition, some state programs are administered by boards and commissions, such as The Regents of the University of

California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over many functions of state government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three sectors: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 42,400 degrees were awarded in the 1998-99 school year. About 179,600 full-time students were enrolled at the nine UC campuses and the Hastings School of Law in the fall of 1999. The California State University System, consisting of 23 campuses, provides undergraduate and graduate degrees to students. Approximately 68,500 degrees were awarded in the 1998-99 school year. About 274,000 full-time students were enrolled at the 23 campuses. The third sector consists of 107 campuses operated by 72 community college districts which provide associate degrees and certificates. Approximately 92,000 associate degrees and certificates were awarded in the 1998-99 school year. About 1.5 million students were enrolled in California's community colleges in the fall of 1999.

Employee Relations

In 1999-00, the State work force is estimated to be comprised of approximately 299,000 personnel years, of which approximately 96,000 personnel years represent employees of institutions of higher education. State employees who are subject to collective bargaining represent approximately 150,000 personnel years. The California State Employees' Association (CSEA), represents 9 of the 21 collective bargaining units, or approximately 52 percent of those employees subject to collective bargaining.

State law provides that state employees, defined as any civil service employee of the State and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. Law enforcement employees have the right to be represented separately from other employees. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding (MOU) and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

The State has ratified new two-year MOUs effective as of July 1, 1999, with all twenty-one collective bargaining units. The State has not experienced a major work stoppage in the last 23 years.

Employees' Retirement Systems

The information below has been provided by the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). For further information concerning these retirement systems, please see the website for CalPERS at www.calpers.ca.gov and the website for CalSTRS at www.calstrs.ca.gov.

CalPERS and CalSTRS are two retirement systems administered by the State. The pension liability for all the pension trust funds administered by CalPERS is determined in accordance with Governmental Accounting Standards Board (GASB) Statement No. 25. CalPERS' and CalSTRS' investments are reported at fair value, generally determined based on published market prices, quotations from major investment firms, and other factors for assets without a published market price.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement System (PERS), the Judges' Retirement System, the Judges' Retirement System II, the Legislators' Retirement System, and the Volunteer Firefighters' Length of Service Award Fund. CalPERS also administers two defined contribution plans, the State Peace Officers' and Firefighters' Defined Contribution Plan and the Supplemental Contributions Program. CalPERS also administers a deferred compensation plan – the CalPERS 457 Plan. CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715.

CalPERS uses the accrual basis of accounting. Member contributions are recorded when due. Employer contributions are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due in accordance with the terms of each plan.

All State, classified school and participating local agency employees who work on a half time or more basis are eligible to participate in PERS. Benefits are based on members' years of service, age, final compensation, and benefit formula as calculated under the applicable plans. Vesting occurs after five or ten years depending on the plan. All plans provide death, disability, and survivor benefits. The benefits provisions under each plan are established by statute.

Under the State Constitution, CalPERS has the authority to invest in stocks, bonds, mortgages, real estate, and other prudent investments. CalPERS also holds investments in futures and options and enters into forward foreign currency exchange contracts. CalPERS had assets with a fair market value of \$161 billion as of October 31, 1999.

The PERS is administered by the Board of Administration of CalPERS. As of June 30, 1999, employers participating in PERS include the State, 61 school employers, 1,311 public agencies and certain special purpose authorities, which are legally separate from the State. At June 30, 1999, PERS had approximately 343,341 retirees, survivors and beneficiaries receiving a monthly allowance and 816,512 active and inactive members.

Benefits are funded by contributions from members and the employers and earnings from investments. Member and employer contributions are a percentage of the applicable member's compensation. The contribution from members is defined by law and based on the applicable benefit formula. The employer contribution rates are determined by periodic actuarial valuations. State contributions are paid quarterly and other employer contributions are paid monthly.

The net assets in excess of the total actuarial accrued liability of PERS relating to State employees was \$6.817 billion as of June 30, 1998. PERS had assets with a total actuarial value of \$128.8 billion as of June 30, 1998.

CalSTRS administers the California State Teachers' Retirement Fund (TRF), which is comprised of two distinct benefit plans: a Defined Benefit (DB) Program as set forth in Part 13 of the California Education Code and a Cash Balance (CB) Benefit Program as set forth in Part 14 of the California Education Code. Together, Parts 13 and 14 are referred to as the "Teachers' Retirement Law." CalSTRS also offers through a third party administrator a defined contribution plan that meets the requirements of the Internal Revenue Code Section 403(b) and is open to any employee who is eligible to participate. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information on the plans. This report may be obtained from the California State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and State contributions are recognized when due and the employer or the State has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the retirement program. CalSTRS' investments consist of government, corporate, and international bonds, domestic and international equities, mutual funds, limited partnership holdings, real estate, mortgages, and other investments. At November 30, 1999, CalSTRS had reported assets of \$104.782 billion.

CalSTRS administers the TRF, a cost sharing multiple-employer defined benefit retirement plan that provides pension benefits to teachers and certain other employees of the California public school system. Membership in the TRF is mandatory for all employees meeting the eligibility requirements. The State Teachers' Retirement Law establishes the benefits for the TRF. At June 30, 1999, the TRF had approximately 1,160 contributing school districts. At June 30, 1998, there were 471,332 plan members, and 161,457 benefit recipients. The State is a nonemployer contributor to the TRF.

Benefits for the DB Program are funded under the TRF by contributions from members, employers, the State, and earnings from investments. Member and employer contributions are a percentage of applicable member earnings. The State Teachers' Retirement Law governs

member rates (8 percent of the applicable member's earnings), employer contribution rates (8.25 percent of the applicable member's earnings), and the State's contributions. The State's quarterly contribution to CalSTRS, commencing October 1, 1998, is set at 3.102 percent of the total of the creditable compensation of the prior calendar year upon which members' contributions are based, plus up to 1.5 percent of the total of the creditable compensation of the prior calendar year upon which members' contributions are based, which is contributed until the unfunded obligation and any normal cost deficit for the benefits in effect on July 1, 1990 is eliminated. Currently there is no unfunded obligation or normal cost deficit. Therefore, no contributions are being made for this purpose.

CalSTRS administers the CB Benefit Program as a separate defined benefit plan designed for the employees of California public schools who are hired to perform creditable service for less than 50 percent of the full time equivalent for the position. At December 31, 1999, the CB Benefit Program had 20 contributing school districts, 7,444 contributing participants and assets of \$6.5 million.

For the year ended June 30, 1998, the excess of actuarial value of assets over actuarial accrued liability for the TRF, was \$3.056 billion and the actuarial value of assets was \$77.290 billion.

Year 2000-Related Information Technology

The State's Department of Information Technology has received no reports that the State experienced any interruption in the delivery of mission critical services as a result of the date change to the Year 2000 or during the leap year period of February 28-29 and March 1, 2000.

STATE INDEBTEDNESS

General

The State Treasurer is responsible for the sale of debt obligations of the State and its various authorities and agencies. The State has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper, lease-purchase debt and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

Capital Facilities Financing

General Obligation Bonds - The State Constitution prohibits the creation of general obligation indebtedness of the State unless a bond law is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of February 1, 2000, the State had outstanding \$20,383,001,000 aggregate principal amount of long-term general obligation bonds, and unused voter authorizations for the future issuance of \$11,702,749,000 of long-term general obligation bonds. This latter figure consists of \$4,123,734,000 of authorized commercial paper notes, described below (of which \$959,565,000 was outstanding), which had not yet been refunded by general obligation bonds, and \$7,579,015,000 of other authorized but unissued general obligation debt. See the table "Authorized and Outstanding General Obligation Bonds" under "State Debt Tables" following page A-41.

The General Obligation Bond Law permits the State to issue variable rate indebtedness, up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. As of January 1, 2000, there was no variable rate indebtedness outstanding; however, the State plans to issue such indebtedness in the future.

At the March 7, 2000 election, voters approved four bond acts, totaling \$4.470 billion in new authorizations and rejected one bond act for \$220 million. Additional bond authorizations may be voted at the November 7, 2000 election.

Commercial Paper Program - Pursuant to legislation enacted in 1995, voter approved general obligation indebtedness may be issued either as long-term bonds, or, for some but not all bond acts, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. The State issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes. Pursuant to the terms of the bank credit agreement presently in effect supporting the general obligation commercial paper program, not more than \$1.5 billion of general obligation commercial paper notes may be outstanding at any time; this amount may be increased or decreased in the future. Commercial paper notes are deemed issued upon authorization by the respective Finance Committees, whether or not such notes are actually issued. As of February 1, 2000, the Finance Committees had authorized the issuance of up to \$4,123,734,000 of commercial paper notes; as of that date \$959,565,000 aggregate principal amount of general obligation commercial paper notes was outstanding.

Lease-Purchase Debt - In addition to general obligation bonds, the State builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another State or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a State agency or the University of California under a long-term lease which provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the State's lease obligation, which are marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the Constitutional provisions which require voter approval. For purposes of this section of the Official Statement and the tables following, "lease-purchase debt" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a

State energy efficiency program secured by payments made by various State agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund (see "State Finances--Sources of Tax Revenue"). The table does not include equipment leases or leases which were not sold, directly or indirectly, to the public capital market. The State had \$5,713,574,434 General Fund-supported lease-purchase debt outstanding at February 1, 2000. The State Public Works Board, which is authorized to sell lease revenue bonds, had \$1,836,518,000 authorized and unissued as of February 1, 2000.

Non-Recourse Debt - Certain State agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from State revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. There are 17 agencies and authorities authorized to issue revenue obligations (excluding lease-purchase debt). State agencies and authorities had \$26,008,006,628 aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of June 30, 1999, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "State Debt Tables" following page A-41.

Detailed tables showing the State's long-term debt appear after page A-41.

Cash Flow Borrowings

As part of its cash management program, the State has regularly issued short-term obligations to meet cash flow needs. The following table shows the amount of revenue anticipation notes ("Notes") issued over the past five fiscal years. See "Prior Fiscal Years' Financial Results" and "Current State Budget" below.

The State issued \$1.0 billion of revenue anticipation notes for the 1999-2000 Fiscal Year to mature on June 30, 2000.

State of California Revenue Anticipation Notes Issued Fiscal Years 1995-96 to 1999-2000

<u>Fiscal Year</u>	<u>Type</u>	<u>Principal Amount (Billions)</u>	<u>Date of Issue</u>	<u>Maturity Date</u>
1995-1996	Notes	\$2.0	April 25, 1996	June 28, 1996
1996-1997	Notes Series A-C	3.0	August 6, 1996	June 30, 1997
1997-1998	Notes	3.0	September 9, 1997	June 30, 1998
1998-1999	Notes	1.7	October 1, 1998	June 30, 1999
1999-2000	Notes Series A-B	1.0	October 1, 1999	June 30, 2000

SOURCE: State of California, Office of the Treasurer.

STATE FINANCES

The Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a budget basis, using a modified accrual system of accounting, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues and balances available from prior fiscal years. Following the submission of the Governor's Budget, the Legislature takes up the proposal.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorizations is the Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Bills containing appropriations (except for K-14 education) must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing K-14 education appropriations only require a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution. There is litigation pending concerning the validity of such continuing appropriations. See "Litigation" below.

Funds necessary to meet an appropriation need not be in the State Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

The General Fund

The moneys of the State are segregated into the General Fund and over 900 special funds, including bond, trust and pension funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the State. For additional financial data relating to the General Fund, see Exhibit 1 to this Appendix A. The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor, as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

The Special Fund for Economic Uncertainties

The Special Fund for Economic Uncertainties (“SFEU”) is funded with General Fund revenues and was established to protect the State from unforeseen revenue reductions and/or unanticipated expenditure increases. Amounts in the SFEU may be transferred by the State Controller as necessary to meet cash needs of the General Fund. The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund.

The legislation creating the SFEU (Government Code §16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the State’s “appropriations subject to limitation” for the fiscal year then ended and its “appropriations limit” as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the State’s Legislative Analyst’s Office and the Department of Finance. For a further description of Article XIII B, see “State Appropriations Limit” below. In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

The June 30, 2000, SFEU projection reflects the latest revenue projections and expenditure amounts as updated in 2000-01 Governor’s Budget. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors including re-estimates of revenues and expenditures, existing statutory requirements, and additional legislation introduced and passed by the Legislature may impact the reserve amount.

At the time of the release of the 2000-01 Governor’s Proposed Budget, on January 10, 2000, the Department of Finance projected the SFEU would have a balance of about \$2.420 billion at June 30, 2000, compared to the amount of \$880 million projected at the time the 1999 Budget Act was signed on June 29, 1999. See “Current State Budget” below.

Inter-Fund Borrowings

Inter-fund borrowing has been used for many years to meet temporary imbalances of receipts and disbursements in the General Fund. As of June 30, 1999, the General Fund had no outstanding loans from the SFEU, General Fund special accounts or other special funds.

In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the “PMIB,” consisting of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund from such special funds, as determined by the PMIB. All

money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made from a special fund which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

Although any determination of whether a proposed borrowing from one of the special funds is permissible, any such determination must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The Attorney General of the State has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the State.

At the November 1998 election voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual budget act. Since the General Fund may reborrow from the transportation accounts soon after the annual repayment is made, the proposition is not expected to have any adverse impact on the State's cash flow.

The following chart shows General Fund internal borrowable resources on June 30 of each of the Fiscal Years 1996-97 through 1998-99 and estimates for 1999-2000 and 2000-01:

General Fund Internal Borrowable Resources
(Cash Basis)
(Millions)

	June 30				
	1997	1998	1999	2000	2001
Available Internal Borrowable Resources	\$6,242.2	\$6,866.8	\$8,720.0	\$7,650.4	\$7,667.3
Outstanding Loans					
From Special Fund for Economic Uncertainties	281.2	-0-	-0-	-0-	896.6
From Special Funds and Accounts	<u>909.2</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Total Outstanding Internal Loans	<u>1,190.4</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>896.6</u>
Unused Internal Borrowable Resources	<u>\$5,051.8</u>	<u>\$6,866.8</u>	<u>\$8,720.0</u>	<u>\$7,650.4</u>	<u>\$6,770.7</u>

SOURCE: State of California, Office of the State Controller and State of California, Department of Finance. Information for the Fiscal Years ended June 30, 1997 through 1999 are actual figures. For the Fiscal Years ending

June 30, 2000 and 2001, these figures were estimated as of December 30, 1999, by the Department of Finance (except for Fiscal Year 1999-2000 Available Internal Borrowable Resources, estimated by the State Controller).

Investment of Funds

Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). As of January 31, 2000, the PMIA held approximately \$23.44 billion of State moneys, and \$13.01 billion of moneys invested for about 2,771 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of January 31, 2000, are shown in the following table:

Analysis of the Pooled Money Investment Account Portfolio*

<u>Type of Security</u>	<u>Amount (Millions)</u>	<u>Percent Of Total</u>
U.S. Treasury Bills and Notes	\$3,905	10.7%
Commercial Paper (corporate)	9,367	25.7
Certificates of Deposits	5,329	14.6
Corporate Bonds	2,541	7.0
Federal Agency Securities	8,596	23.6
Bankers Acceptances	0	0
Bank Notes	2,290	6.3
Loans Per Government Code	2,097	5.8
Time Deposits	2,918	8.0
Repurchases	0	0
Reverse Repurchases	(590)	(1.6)
	<u>\$36,453</u>	<u>100%</u>

*Totals may not add due to rounding.

SOURCE: State of California, Office of the Treasurer.

The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB (consisting of the State Treasurer, the State Controller and the Director of Finance). The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of January 31, 2000 was 193 days.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by State law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient “Unapplied Money” available to pay a warrant when it is drawn, referred to generally as “registered warrants” and “reimbursement warrants.” “Unapplied Money” consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid. Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from the special funds (to the extent permitted by law).

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a “registered warrant” to persons or entities (e.g., employees, suppliers and local governments) otherwise entitled to receive payments from the State. A registered warrant bears interest at a rate designated by the PMIB up to a maximum of 5 percent per annum. Registered warrants have no fixed maturity date, but are redeemed when the Controller, with the approval of the PMIB, determines there would be sufficient Unapplied Money in the General Fund. The State Controller notifies the State Treasurer, who publishes a notice that the warrants in question are payable.

In lieu of issuing individual registered warrants to numerous creditors, there is an alternative procedure whereby the Governor, upon request of the State Controller, may create a General Cash Revolving Fund in the State Treasury which may borrow from other State special funds to meet payments authorized by law. The State Controller may then issue “reimbursement warrants” at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund is created solely to facilitate the issuance of registered reimbursement warrants. Reimbursement warrants have a fixed maturity date, and must be paid by the State Treasurer on their maturity date from any Unapplied Money in the General Fund and available therefor.

Welfare Reform

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104-193, the “Law”) has fundamentally reformed the nation’s welfare system. Among its many provisions, the Law includes: (i) conversion of Aid to Families with Dependent Children from an entitlement program to a block grant titled Temporary Assistance for Needy Families (TANF), with lifetime time limits on TANF recipients, work requirements and other changes; (ii) provisions denying certain federal welfare and public benefits to legal noncitizens (this

provision has been amended by subsequent federal law), allowing states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally denying almost all benefits to illegal immigrants; and (iii) changes in the Food Stamp program, including reducing maximum benefits and imposing work requirements. The block grant formula under the Law is operative through federal fiscal year 2002.

California's response to the federal welfare reforms is embodied in Chapter 270, Statutes of 1997. This basic state welfare program, called California Work Opportunity and Responsibility to Kids ("CalWORKs"), replaced the former Aid to Families with Dependent Children (AFDC) and Greater Avenues to Independence (GAIN) programs, effective January 1, 1998. Consistent with the federal law, CalWORKs contains time limits on receipt of welfare aid, both lifetime as well as for any current period on aid. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements. Administration of the CalWORKs program is largely at the county level, and the counties receive financial incentives for success in this program. Counties have been successful in earning performance incentive payments and have earned amounts in excess of the available appropriation for 1998-99 and, it is estimated, for 1999-00 as well. The Administration proposes to repeal or modify the current incentive structure in 2000-01 to permit adequate funding for other CalWORKs program demands in the future.

To date, the implementation of the CalWORKs program has continued the trend of declining welfare caseloads. The CalWORKs caseload is projected to be 589,000 in 1999-00 and 557,000 in 2000-01, down from a high of 921,000 cases in 1994-95. The longer-term impact of the new federal Law and CalWORKs is being evaluated by the RAND Corporation, with a series of reports to be furnished and the final report due October 2001.

The 2000-01 CalWORKs budget reflects California's success in meeting the federally-mandated work participation requirements for federal fiscal year 1998. With that goal being met, the federally-imposed maintenance-of-effort (MOE) level for California is reduced from 80 percent of the federal fiscal year 1994 baseline expenditures for the former AFDC program (\$2.9 billion) to 75 percent (\$2.7 billion). It is still uncertain if the state will meet the work participation requirements for federal fiscal year 1999; however, due to program changes, it is expected that California will meet the work participation goal in federal fiscal year 2000 and beyond. In addition, California will receive a TANF High Performance Bonus award of \$45.5 million. This one-time bonus is awarded to states for their successes in moving welfare recipients to work and sustaining their participation in the workforce.

The 2000-01 Governor's Budget proposes expenditures which will continue to meet, but not exceed, the federally-required \$2.7 billion combined State and county MOE requirement. Total CalWORKs-related expenditures are estimated to be \$7.2 billion for 1999-00 and \$6.9 billion for 2000-01, including child care transfer amounts for the Department of Education.

Local Governments

The primary units of local government in California are the counties, ranging in population from 1,200 in Alpine County to over 9,600,000 in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails

and public safety in unincorporated areas. There are also about 470 incorporated cities, and thousands of special districts formed for education, utility and other services. The fiscal condition of local governments has been constrained since the enactment of "Proposition 13" in 1978, which reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Counties, in particular, have had fewer options to raise revenues than many other local government entities, and have been required to maintain many services.

In the aftermath of Proposition 13, the State provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including taking over the principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990's, the Legislature eliminated most of the remaining components of post-Proposition 13 aid to local government entities other than K-14 education districts by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources (such as sales taxes) and reduced certain mandates for local services. Since then the State has also provided additional funding to counties and cities through such programs as health and welfare realignment, welfare reform, trial court restructuring, the COPs program supporting local public safety departments, and various other measures.

The 1999 Budget Act includes a \$150 million one-time subvention from the General Fund to local agencies for relief from the 1992 and 1993 property tax shifts. Legislation has been passed, subject to voter approval at the election in November, 2000, to provide a more permanent payment to local governments to offset the property tax shift. In addition, legislation was enacted in 1999 to provide approximately \$35.8 million annual relief to cities based on 1997-98 costs of jail booking and processing fees paid to counties.

Historically, funding for the State's trial court system was divided between the State and the counties. However, Chapter 850, Statutes of 1997, implemented a restructuring of the State's trial court funding system. Funding for the courts, with the exception of costs for facilities, local judicial benefits, and revenue collection, was consolidated at the State level. The county contribution for both their general fund and fine and penalty amounts is capped at the 1994-95 level and becomes part of the Trial Court Trust Fund, which supports all trial court operations. The State assumed responsibility for future growth in trial court funding. The consolidation of funding is intended to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. Beginning in 1998-99, the county general fund contribution for court operations was reduced by \$290 million, and cities retained \$62 million in fine and penalty revenue previously remitted to the State. The General Fund reimbursed the \$352 million revenue loss to the Trial Court Trust Fund. The 1999 Budget Act included funds to further reduce the county general fund contribution by an additional \$96 million.

The entire statewide welfare system has been changed in response to the change in federal welfare law enacted in 1996 (see "Welfare Reform" above). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with State law, to implement the program and to administer many of its elements, and their costs for administrative and supportive services are capped at the 1996-97 levels. Counties are also given financial incentives

if, at the individual county level or statewide, the CalWORKs program produces savings associated with specified standards. Counties will still be required to provide “general assistance” aid to certain persons who cannot obtain welfare from other programs.

In 1996, voters approved Proposition 218, entitled the “Right to Vote on Taxes Act,” which incorporates new Articles XIII C and XIII D into the California Constitution. These new provisions place limitations on the ability of local government agencies to impose or raise various taxes, fees, charges and assessments without voter approval. Certain “general taxes” imposed after January 1, 1995, must be approved by voters in order to remain in effect. In addition, Article XIII C clarifies the right of local voters to reduce taxes, fees, assessments or charges through local initiatives. There are a number of ambiguities concerning the Proposition and its impact on local governments and their bonded debt which will require interpretation by the courts or the Legislature. Proposition 218 does not affect the State or its ability to levy or collect taxes.

State Appropriations Limit

The State is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the “Appropriations Limit”). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the State from spending “appropriations subject to limitation” in excess of the Appropriations Limit. “Appropriations subject to limitation,” with respect to the State, are authorizations to spend “proceeds of taxes,” which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed “the cost reasonably borne by that entity in providing the regulation, product or service,” but “proceeds of taxes” exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not “proceeds of taxes,” such as reasonable user charges or fees and certain other non-tax funds.

Not included in the Appropriations Limit are appropriations for the debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes). The Appropriations Limit may also be exceeded in cases of emergency.

The State’s Appropriations Limit in each year is based on the limit for the prior year, adjusted annually for changes in state per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college (“K-14”) districts. The Appropriations Limit is tested over consecutive

two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the State's Appropriations Limit for the past three fiscal years, the current fiscal year and the proposed budget year. As of the release of the 2000-01 Governor's Budget, the Department of Finance projects the State's Appropriations Subject to Limitations will be \$3.8 billion under the State's Appropriations Limit in Fiscal Year 1999-00 and \$4.0 billion in Fiscal Year 2000-01.

**State Appropriations Limit
(Millions)**

	Fiscal Years				
	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99*</u>	<u>1999-00*</u>	<u>2000-01*</u>
State Appropriations Limit	\$42,002	\$44,778	\$47,573	\$50,673	\$53,419
Appropriations Subject to Limit	<u>(35,103)</u>	<u>(40,743)</u>	<u>(43,695)</u>	<u>(46,896)</u>	<u>(49,444)</u>
Amount (Over)/Under Limit	<u>\$6,899</u>	<u>\$4,035</u>	<u>\$3,878</u>	<u>\$3,777</u>	<u>\$3,975</u>

*Estimated/Projected

SOURCE: State of California, Department of Finance.

Proposition 98

On November 8, 1988, voters of the State approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed State funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 schools a minimum share of General Fund revenues. Under Proposition 98 (as modified by Proposition 111, which was enacted on June 5, 1990), K-14 schools are guaranteed the greater of (a) in general, a fixed percent of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 schools in the prior year, adjusted for changes in the cost of living (measured as in Article XIII B by reference to State per capita personal income) and enrollment ("Test 2"), or (c) a third test, which would replace Test 2 in any year when the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in State per capita personal income ("Test 3"). Under Test 3, schools would receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus an additional small adjustment factor. If Test 3 is used in any year, the difference between Test 3 and Test 2 would become a "credit" to schools which would be the basis of payments in future years when per capita General Fund revenue growth exceeds per capita personal income growth. Legislation adopted prior to the end of the 1988-89 Fiscal

Year, implementing Proposition 98, determined the K-14 schools' funding guarantee under Test 1 to be 40.3 percent of the General Fund tax revenues, based on 1986-87 appropriations. However, that percent has been adjusted to approximately 35 percent to account for a subsequent redirection of local property taxes, since such redirection directly affects the share of General Fund revenues to schools.

Proposition 98 permits the Legislature by two-thirds vote of both houses, with the Governor's concurrence, to suspend the K-14 schools' minimum funding formula for a one-year period. Proposition 98 also contains provisions transferring certain State tax revenues in excess of the Article XIII B limit to K-14 schools (see "State Finances--State Appropriations Limit" above).

During the recession in the early 1990s, General Fund revenues for several years were less than originally projected, so that the original Proposition 98 appropriations turned out to be higher than the minimum percentage provided in the law. The Legislature responded to these developments by designating the "extra" Proposition 98 payments in one year as a "loan" from future years' Proposition 98 entitlements, and also intended that the "extra" payments would not be included in the Proposition 98 "base" for calculating future years' entitlements. By implementing these actions, per-pupil funding from Proposition 98 sources stayed almost constant at approximately \$4,200 from Fiscal Year 1991-92 to Fiscal Year 1993-94.

In 1992, a lawsuit was filed, called *California Teachers' Association v. Gould*, which challenged the validity of these off-budget loans. The settlement of this case, finalized in July, 1996, provides, among other things, that both the State and K-14 schools share in the repayment of prior years' emergency loans to schools. Of the total \$1.76 billion in loans, the State is repaying \$935 million by forgiveness of the amount owed, while schools will repay \$825 million. The State share of the repayment will be reflected as an appropriation above the current Proposition 98 base calculation. The schools' share of the repayment will count as appropriations that count toward satisfying the Proposition 98 guarantee, or from "below" the current base. Repayments are spread over the eight-year period of 1994-95 through 2001-02 to mitigate any adverse fiscal impact.

Substantially increased General Fund revenues, above initial budget projections, in the fiscal years 1994-95 through 1999-00 have resulted in retroactive increases in Proposition 98 appropriations from subsequent fiscal years' budgets. Because of the State's increasing revenues, per-pupil funding at the K-12 level has increased by about 50 percent from the level in place in 1991-92, and is estimated at about \$6,313 per ADA in 2000-01. A significant amount of the "extra" Proposition 98 monies in the last few years has been allocated to special programs, including an initiative to increase the number of computers in schools throughout the State. Furthermore, since General Fund revenue growth is expected to continue in 2000-01, the Governor has also proposed new initiatives to improve student achievement, provide better teacher recruitment and training, and provide schools with advanced technology and the opportunity to form academic partnerships to help them meet increased expectations. See "Current State Budget" for further discussion of education funding.

Sources of Tax Revenue

The following is a summary of the State's major revenue sources. Further information on State revenues is contained under "Current State Budget" and "State Finances -- Recent Tax Receipts" below.

Personal Income Tax

The California personal income tax, which in 1998-99 contributed about 53 percent of General Fund revenues and transfers, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions). The tax is progressive with rates ranging from 1.0 percent to 9.3 percent. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (AMT) which is much like the federal AMT.

Taxes on capital gains realizations, which have in part been linked to stock market performance, have become a larger component of personal income taxes in the last few years. For the 1999 tax year, capital gains are projected to be 17 percent of the total personal income tax liability compared to an average of 8.5 percent for the period 1985-94.

The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income.

Sales Tax

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Sales tax accounted for about 32 percent of General Fund revenue and transfers in 1998-99. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft. Pursuant to federal law, sales over the Internet are not taxed by the State at this time.

The breakdown of the basic 7.25 percent rate currently imposed on a statewide basis is:

- 5.00 percent represents the State General Fund tax rate.
- 2.00 percent is dedicated to cities and counties.
- 0.25 percent is dedicated to county transit systems.

Legislation in July 1991 raised the sales tax rate by 1.25 percent to its current level. Of this amount, 0.25 percent was added to the General Fund tax rate, and the balance was dedicated to cities and counties. One-half percent was a permanent addition to counties, but with the money earmarked to trust funds to pay for health and welfare programs whose administration was transferred to counties. Another 0.5 percent of the State General Fund tax rate that was scheduled to terminate after June 30, 1993, was extended until December 31, 1993, and allocated

to local agencies for public safety programs. Voters in a special election on November 2, 1993, approved a constitutional amendment to permanently extend this 0.5 percent sales tax for local public safety programs.

Currently, 0.25 percent of the state tax rate may be terminated upon certification by the Director of Finance that the balance in the budget reserve for two consecutive years will exceed 4 percent of General Fund revenues. The 0.25 percent rate can be reinstated if the Director of Finance subsequently determines that the reserve will not exceed 4 percent of General Fund revenues.

Bank and Corporation Tax

Bank and corporation tax revenues, which comprised about 10 percent of General Fund revenues and transfers in 1998-99, are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the State.
2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.
3. The alternative minimum tax (AMT) is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.
4. A minimum franchise tax of up to \$800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. Beginning in 2000, all new corporations are exempted from the minimum franchise tax for the first two years of incorporation.
5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. Insurance taxes comprised approximately 2.1 percent of General Fund revenues and transfers in 1998-99.

Other Taxes

Other General Fund major taxes and licenses include: Estate, Inheritance and Gift Taxes, Cigarette Taxes, Alcoholic Beverage Taxes, Horse Racing Revenues and trailer coach license fees. These other sources totaled approximately 2.3 percent of General Fund revenues and transfers in the 1998-99 Fiscal Year.

Special Fund Revenues

The California Constitution, codes and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

1. Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
2. Charges for special services to specific functions, including such items as business and professional license fees.
3. Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 55 percent of all special fund revenues and transfers in 1998-99. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During the 1998-99 fiscal year, \$8.6 billion was derived from the ownership or operation of motor vehicles. This was only 1.0 percent above the 1997-98 level, due to tax reductions enacted for vehicle license fees. About \$4.7 billion of this revenue was returned to local governments. The remainder was available for various state programs related to transportation and services to vehicle owners. These amounts (as well as those shown below in the table "Comparative Yield of State Taxes--All Funds") include the additional fees and taxes derived from the passage of Proposition 111 in June 1990.

Chapter 322, Statutes of 1998 established a vehicle license fee offset program. Pursuant to this chapter, vehicle license fees were reduced by 25 percent beginning January 1, 1999. In addition, Chapter 74, Statutes of 1999, provided a one-time expansion of the offset program by an additional 10 percent for the 2000 calendar year only, and Chapter 76, Statutes of 1999, allowed a one-year reduction in vehicle license fees for certain commercial motor vehicles. For 1999-00 and 2000-01, the offset program is expected to reduce revenues by \$1.350 billion and \$1.712 billion, respectively. This loss of local revenue is replaced by the State's General Fund.

Vehicle license fees, over and above the costs of collection and refunds authorized by law, are constitutionally defined local revenues. A continuous appropriation from the General Fund replaces the vehicle license fee revenue that local governments would otherwise lose due to the fee reductions. If in any year the Legislature fails to appropriate enough funds to fully offset the then-applicable vehicle license fee reduction, the percentage offset will be reduced to assure that local governments are not disadvantaged.

In addition to the initial 25 percent reduction, Chapter 322 also sets out a series of “trigger” levels, so that the percentage fee reduction could be increased in annual stages up to a maximum of 67.5 percent in 2003 depending on whether future General Fund revenues reach the target levels. In order for the next 10 percent fee reduction, which will result in a cumulative 35 percent cut from 1998 base levels, to go into effect permanently beginning calendar year 2001, General Fund revenues in FY 2000-01 would need to reach about \$65.5 billion. Based on the current revenue forecast, the 35 percent offset will go into effect in the 2001 calendar year.

On November 8, 1988, voters approved Proposition 99, which imposed, as of January 1, 1989, an additional 25 cents per pack excise tax on cigarettes, and a new, equivalent excise tax on other tobacco products. The initiative requires that funds from this tax be allocated to anti-tobacco education and research and indigent health services, and environmental and recreation programs. Legislation enacted in 1993 added an additional 2 cents per pack excise tax for the purpose of funding breast cancer research.

Proposition 10, approved in 1998, increased the excise tax imposed on distributors selling cigarettes in California to 87 cents per pack effective January 1, 1999. At the same time, this proposition imposed a new excise tax on cigars, chewing tobacco, pipe tobacco, and snuff at a rate equivalent to the tax increase on cigarettes of 50 cents per pack. In addition, the higher excise tax on cigarettes automatically triggered an additional increase in the tax on other tobacco products effective July 1, 1999, with the proceeds going to the Cigarette and Tobacco Products Surtax Fund. Thus, this proposition increased the total excise tax on other tobacco products by an amount equivalent to an increase in the cigarette tax of one dollar per pack.

The state excise tax on cigarettes of 87 cents per pack and other tobacco product taxes are earmarked as follows:

- Fifty cents of the per-pack tax on cigarettes, and the equivalent rate levied on non-cigarette tobacco products, goes to the California Children and Families First Trust Fund and is allocated primarily for early childhood development programs.
- Twenty-five cents of the per-pack tax on cigarettes, and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs. This portion of the excise tax was imposed on January 1, 1989, as voters approved Proposition 99 of 1988.
- Ten cents of the per-pack tax is allocated to the State’s General Fund.

The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund. Legislation enacted in 1993 added the additional per pack excise tax for the purpose of funding breast cancer research.

Tobacco Litigation

In late 1998, the State signed a settlement agreement with the four major cigarette manufacturers. The State agreed to drop its lawsuit and not to sue in the future. Tobacco manufacturers agreed to billions of dollars in payments and restrictions in marketing activities. Under the settlement, the companies will pay California governments a total of approximately \$25 billion over a period of 25 years. In addition, payments of approximately \$1 billion per year will continue in perpetuity. Under the settlement, half of the moneys will be paid to the State and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The State's revised 1999-2000 Budget includes receipt of \$517 million of settlement money to the General Fund. The Governor's Budget for 2000-01 projects receipt of \$388 million of settlement money to the General Fund.

The specific amount to be received by the State and local governments is subject to adjustment. Details in the settlement allow reduction of the companies' payments because of federal government actions, or reductions in cigarette sales. Settlement payments can increase due to inflation or increases in cigarette sales. The "second initial" payment, received in December 1999, was 14 percent lower than the base settlement amount due to reduced sales. Future payment estimates have been reduced by a similar percentage. In the event that any of the companies goes into bankruptcy, the State could seek to terminate the agreement with respect to those companies filing bankruptcy actions thereby reinstating all claims against those companies. The State may then pursue those claims in the bankruptcy litigation, or as otherwise provided by law. Also, several parties have brought a lawsuit challenging the settlement and seeking damages; see "Litigation" below.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per \$100 of personal income for the past four years, the current fiscal year and the budget year.

Trend of State Taxes

<u>Fiscal Year</u>	<u>Taxes per Capita(a)</u>		<u>Taxes per \$100 of Personal Income</u>	
	<u>General Fund</u>	<u>Total</u>	<u>General Fund</u>	<u>Total</u>
1995-96.....	\$1,398.03	\$1,709.28	\$5.94	\$7.27
1996-97.....	1,480.87	1,803.40	6.01	7.32
1997-98.....	1,634.22	1,967.00	6.37	7.66
1998-99(p).....	1,737.59	2,080.61	6.44	7.71
1999-00(b).....	1,864.11	2,206.46	6.58	7.79
2000-01(b).....	1,927.95	2,271.79	6.49	7.65

(a) Data reflect population figures benchmarked to the 1990 Census.

(b) Estimated.

(p) Preliminary.

SOURCE: State of California, Department of Finance.

The following table gives the actual and estimated growth in revenues by major source for the last four years, the current fiscal year, and the budget year.

COMPARATIVE YIELD OF STATE TAXES—ALL FUNDS
1995-96 THROUGH 2000-01
(Modified Accrual Basis)
(Thousands of Dollars)

<u>Year</u> <u>Ending</u> <u>June 30</u>	<u>Sales and</u> <u>Use(a)</u>	<u>Personal</u> <u>Income</u>	<u>Bank and</u> <u>Corporation</u> <u>(b)</u>	<u>Tobacco(c)</u>	<u>Inheritance,</u> <u>Estate and</u> <u>Gift</u>	<u>Insurance</u>	<u>Alcoholic</u> <u>Beverages</u>	<u>Horse</u> <u>Racing</u>	<u>Motor</u> <u>Vehicle</u> <u>Fuel(d)</u>	<u>Motor</u> <u>Vehicle</u> <u>Fees(e)</u>
1996	19,088,313	20,877,687(f)	5,862,420	666,779	659,338	1,131,737	269,227	104,158	2,757,289	5,009,319
1997	20,111,743	23,275,990	5,788,414	665,415	599,255	1,199,554	271,065	90,627	2,824,589	5,260,355
1998	21,331,691	27,927,940	5,836,881	644,297	780,197	1,221,285	270,947	81,930	2,853,846	5,660,574
1999	22,890,693	30,894,865	5,724,237	976,512	890,490	1,253,972	273,112	61,185	3,025,226	5,610,374
2000(g)	22,456,806(h)	34,461,000	6,092,000	1,296,800	937,000	1,277,000	273,800	34,886	3,091,957	5,177,570
2001(g)	23,747,901(h)	36,319,000	6,236,000	1,273,500	984,000	1,304,000	272,500	34,082	3,172,067	5,226,963

(a) For Fiscal Years 1995-96 through 1998-99, numbers include local tax revenue from the 0.5 percent rate increase that the voters passed in November 1993, for local public safety services. For Fiscal Years 1999-00 and 2000-01 the estimates do not include this revenue.

(b) Includes the corporation income tax and, from 1996 through 1997, the unitary election fee.

(c) Proposition 10 (November 1998) increased the cigarette tax to \$0.87 per pack and added the equivalent of \$1.00 tax to other tobacco products.

(d) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(e) Registration and weight fees, motor vehicle license fees and other fees. Due to the offset program, 1998-99 vehicle license fee values reflect a 25 percent reduction for 1999. The values reflect a 35 percent reduction for 2000, and an assumed 35 percent reduction in 2001 as well.

(f) Reflects temporary increase in top marginal rate to 11 percent, which reverted to 9.3 percent for tax years after January 1, 1996.

(g) Estimated. See "Current State Budget."

(h) As stated in footnote (a), the figures for Fiscal Years 1999-00 and 2000-01 do not include voter approved local revenue.

SOURCE: Fiscal Years 1995-96 through 1998-99: State of California, Office of the State Controller.

Fiscal Years 1999-00 and 2000-01: State of California, Department of Finance.

State Expenditures

The following table summarizes the major categories of State expenditures, including both General Fund and special fund programs.

GOVERNMENTAL COST FUNDS (Budgetary Basis) Schedule of Expenditures by Function and Character 1994-95 to 1998-99 Fiscal Years (Thousands)					
	<u>1994-95</u>	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>
Function					
Legislative, Judicial, Executive					
Legislative.....	\$ 180,769	\$ 187,768	\$ 196,642	\$ 209,690	\$ 219,814
Judicial	635,916	704,112	716,712	766,932	1,346,131
Executive	653,583	691,264	961,025	919,606	958,189
State and Consumer Services	697,555	749,368	734,238	771,444	829,745
Business, Transportation and Housing					
Business and Housing.....	225,398	243,185	115,089	136,558	136,893
Transportation.....	3,188,749	3,334,648	3,650,506	3,924,428	4,462,905
Trade and Commerce	47,595	51,280	63,789	62,235	130,796
Resources.....	1,141,488	1,179,481	1,310,074	1,323,860	1,695,323
Environmental Protection	459,492	505,206	507,156	605,584	600,060
Health and Welfare	16,675,380	17,275,117	17,987,919	18,059,611	19,616,132
Correctional Programs	3,280,762	3,638,672	3,606,674	3,901,296	4,181,474
Education					
Education-K through 12.....	14,973,978	16,773,927	19,916,015	21,574,341	22,783,975
Higher Education	5,436,640	5,844,282	6,599,573	7,022,658	7,838,117
General Government					
General Administration.....	1,000,650	672,935	743,024	764,615	859,703
Debt Service.....	2,189,529	2,153,682	2,048,475	1,979,211	1,988,176
Tax Relief	480,430	474,179	454,509	453,030	450,213
Shared Revenues.....	3,188,090	3,346,240	3,690,512	3,892,036	4,151,197
Other Statewide Expenditures	(92,508)	202,158	133,309	1,373,823	891,070
Expenditure Adjustment for					
Encumbrances.....	694,288	(7,691)	(190,609)	(162,630)	(461,310)
Credits for Overhead Services by General					
Fund	(156,118)	(130,016)	(147,019)	(125,678)	(144,041)
Statewide Indirect Cost Recoveries	(31,132)	(48,730)	(23,307)	(48,963)	(32,791)
Total	<u>\$54,870,534</u>	<u>\$57,841,067</u>	<u>\$63,074,306</u>	<u>\$67,403,687</u>	<u>\$72,501,771</u>
Character					
State Operations.....	\$16,403,401	\$17,341,247	\$17,924,850	\$20,199,031	21,092,849
Local Assistance	37,680,952	39,973,320	44,686,447	46,666,925	50,734,442
Capital Outlay.....	786,181	526,500	463,009	537,731	674,480
Total	<u>\$54,870,534</u>	<u>\$57,841,067</u>	<u>\$63,074,306</u>	<u>\$67,403,687</u>	<u>\$72,501,771</u>

SOURCE: State of California, Office of the State Controller.

PRIOR FISCAL YEARS' FINANCIAL RESULTS

Following a severe recession beginning in 1990, the State's financial condition improved markedly during the fiscal years starting in 1995-96, with a combination of better than expected revenues, slowdown in growth of social welfare programs, and continued spending restraint based on actions taken in earlier years. The State's cash position also improved, and no external deficit borrowing occurred over the end of the last four fiscal years.

The economy grew strongly during the fiscal years beginning in 1995-96, and as a result, the General Fund took in substantially greater tax revenues (around \$2.2 billion in 1995-96, \$1.6 billion in 1996-97 and \$2.4 billion in 1997-98 and \$1.7 billion in 1998-99) than were initially planned when the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid in 1995-96 and 1996-97 and particularly in 1998-99 to fund new program incentives.

The following were major features of the 1998 Budget Act and certain additional fiscal bills enacted before the end of the legislative session:

1. The most significant feature of the 1998-99 budget was agreement on a total of \$1.4 billion of tax cuts. The central element was a bill which provided for a phased-in reduction of the Vehicle License Fee ("VLF"). Since the VLF is transferred to cities and counties under existing law, the bill provided for the General Fund to replace the lost revenues. Starting on January 1, 1999, the VLF has been reduced by 25 percent, at a cost to the General Fund of approximately \$500 million in the 1998-99 Fiscal Year and about \$1 billion annually thereafter. See "State Finances – Sources of Tax Revenue – Special Fund Revenues" above.

In addition to the cut in VLF, the 1998-99 budget included both temporary and permanent increases in the personal income tax dependent credit (\$612 million General Fund cost in 1998-99, but less in future years), a nonrefundable renters tax credit (\$133 million), and various targeted business tax credits (\$106 million).

2. Proposition 98 funding for K-14 schools was increased by \$1.7 billion in General Fund moneys over revised 1997-98 levels, over \$300 million higher than the minimum Proposition 98 guarantee. Of the 1998-99 funds, major new programs included money for instructional and library materials, deferred maintenance, support for increasing the school year to 180 days and reduction of class sizes in Grade 9. The Budget also included \$250 million as repayment of prior years' loans to schools, as part of the settlement of the *CTA v. Gould* lawsuit. (See "State Finances - Proposition 98" above.)

3. Funding for higher education increased substantially above the actual 1997-98 level. General Fund support was increased by \$340 million (15.6 percent) for the University of California and \$267 million (14.1 percent) for the California State University system. In addition, Community Colleges funding increased by \$300 million (6.6 percent).

4. The Budget included increased funding for health, welfare and social services programs. A 4.9 percent grant increase was included in the basic welfare grants, the first increase in those grants in 9 years.

5. Funding for the judiciary and criminal justice programs increased by about 11 percent over 1997-98, primarily to reflect increased State support for local trial courts and rising prison population.

6. Major legislation enacted after the 1998 Budget Act included new funding for resources projects, a share of the purchase of the Headwaters Forest, funding for the Infrastructure and Economic Development Bank (\$50 million) and funding for the construction of local jails. The State realized savings of \$433 million from a reduction in the State's contribution to the State Teacher's Retirement System in 1998-99.

Final tabulation of revenues and expenditures contained in the 2000-01 Governor's Budget, released on January 10, 2000, reveals that stronger than expected economic conditions in the State produced total 1998-99 General Fund revenues of about \$58.6 billion, almost \$1.6 billion above the 1998 Budget Act estimates. Actual General Fund expenditures were \$57.8 billion, the amount estimated at the 1998 Budget Act. Some of this additional revenue will be directed to K-14 schools pursuant to Proposition 98. The Governor's Budget reports a balance in the SFEU at June 30, 1999, of approximately \$3.1 billion on a budgetary basis.

CURRENT STATE BUDGET

The discussion below of the 1999-00 Fiscal Year budget and the proposed 2000-01 Budget and the table under "Summary of State Revenues and Expenditures" are based on estimates and projections of revenues and expenditures for the current and upcoming fiscal years and must not be construed as statements of fact. These estimates and projections are based upon various assumptions as updated in the 2000-01 Governor's Budget, which may be affected by numerous factors, including future economic conditions in the State and the nation, and there can be no assurance that the estimates will be achieved. See "Current State Budget -- Revenue and Expenditure Assumptions" below.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The Department of Finance issues a monthly Bulletin which reports the most recent revenue receipts as reported by state departments, comparing them to Budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at budget enactment. These bulletins and other reports are available on the Internet at the following websites:

Department of Finance
State Controller
Legislative Analyst

www.dof.ca.gov
www.sco.ca.gov
www.lao.ca.gov

1999-2000 Fiscal Year Budget

On January 8, 1999, Governor Davis released his proposed budget for Fiscal Year 1999-00 (the "January Governor's Budget"). The January Governor's Budget generally reported that General Fund revenues for FY 1998-99 and FY 1999-00 would be lower than earlier projections (primarily due to weaker overseas economic conditions perceived in late 1998), while some caseloads would be higher than earlier projections. The January Governor's Budget proposed

\$60.5 billion of General Fund expenditures in FY 1999-00, with a \$415 million SFEU reserve at June 30, 2000.

The 1999 May Revision showed an additional \$4.3 billion of revenues for combined fiscal years 1998-99 and 1999-00. The completion of the 1999 Budget Act occurred in a timely fashion. The final Budget Bill was adopted by the Legislature on June 16, 1999, and was signed by the Governor on June 29, 1999 (the "1999 Budget Act"), meeting the Constitutional deadline for budget enactment for only the second time in the 1990's.

The final 1999 Budget Act estimated General Fund revenues and transfers of \$63.0 billion, and contained expenditures totaling \$63.7 billion after the Governor used his line-item veto to reduce the legislative Budget Bill expenditures by \$581 million (both General Fund and Special Fund). The 1999 Budget Act also contained expenditures of \$16.1 billion from special funds and \$1.5 billion from bond funds. The Administration estimated that the SFEU would have a balance at June 30, 2000, of about \$880 million. Not included in this amount was an additional \$300 million which (after the Governor's vetoes) was "set aside" to provide funds for employee salary increases (to be negotiated in bargaining with employee unions), and for litigation reserves. The 1999 Budget Act anticipated normal cash flow borrowing during the fiscal year. See "State Indebtedness-Cash Flow Borrowings."

The principal features of the 1999 Budget Act include the following:

1. Proposition 98 funding for K-12 schools was increased by \$1.6 billion in General Fund moneys over revised 1998-99 levels, \$108.6 million higher than the minimum Proposition 98 guarantee. Of the 1999-00 funds, major new programs included money for reading improvement, new textbooks, school safety, improving teacher quality, funding teacher bonuses, providing greater accountability for school performance, increasing preschool and after school care programs and funding deferred maintenance of school facilities. The Budget also includes \$310 million as repayment of prior years' loans to schools, as part of the settlement of the *CTA v. Gould* lawsuit. See also "State Finances – Proposition 98" above.

2. Funding for higher education increased substantially above the actual 1998-99 level. General Fund support was increased by \$184 million (7.3 percent) for the University of California and \$126 million (5.9 percent) for the California State University system. In addition, Community Colleges funding increased by \$324.3 million (6.6 percent). As a result, undergraduate fees at UC and CSU will be reduced for the second consecutive year, and the per-unit charge at Community Colleges will be reduced by \$1.

3. The Budget included increased funding of nearly \$600 million for health and human services.

4. About \$800 million from the general fund will be directed toward infrastructure costs, including \$425 million in additional funding for the Infrastructure Bank, initial planning costs for a new prison in the Central Valley, additional equipment for train and ferry service, and payment of deferred maintenance for state parks.

5. The Legislature enacted a one-year additional reduction of 10 percent of the VLF for calendar year 2000, at a General Fund cost of about \$250 million in each of FY 1999-00 and

2000-01 to make up lost funding to local governments. Conversion of this one-time reduction to a permanent cut will remain subject to the revenue tests in the legislation adopted last year. See “State Finances – Sources of Tax Revenue – Special Fund Revenue” above. Several other targeted tax cuts, primarily for businesses, were also approved, at a cost of \$54 million in 1999-00.

6. A one-time appropriation of \$150 million, to be split between cities and counties, was made to offset property tax shifts during the early 1990’s. Additionally, an ongoing \$50 million was appropriated as a subvention to cities for jail booking or processing fees charged by counties when an individual arrested by city personnel is taken to a county detention facility.

The revised 1999-2000 budget included in the 2000-01 Governor’s Budget also reflects the latest estimated costs or savings as provided in various pieces of legislation passed and signed after the 1999 Budget Act. The revised budget includes \$730 million for various departments for enrollment, caseload and population changes and \$562 million for Smog Impact Fee refunds (see discussion of the *Jordan* case under “Litigation”). Revised 1999-2000 revenues are \$65.2 billion or \$2.2 billion higher than projections at the 1999 Budget Act. Revised 1999-2000 expenditures are \$65.9 billion or \$2.1 billion higher than projections at the 1999 Budget Act.

The State’s Legislative Analyst (LAO) issued a report in February 2000. The LAO report indicates General Fund revenues for the 18-month period (January 2000 through June 2001) could be as much as \$4.2 billion higher than the 2000-01 Governor’s Budget estimates. The LAO estimate was issued after analyzing actual revenues for December 1999 and January 2000, which were not available at the time the Governor’s Budget estimates were prepared. The LAO report assumed the continuation of strong economic growth in the State during this period.

Proposed 2000-01 Fiscal Year Budget

On January 10, 2000, Governor Davis released his proposed budget for Fiscal Year 2000-01. The 2000-01 Governor’s Budget generally reflects that General Fund revenues for Fiscal Year 1999-2000 will be higher than projections made at the time of the 1999 Budget Act.

The Governor’s Budget projects General Fund revenues and transfers in 2000-01 of \$68.2 billion. This includes anticipated payments from the tobacco litigation settlement of \$387.9 million and the receipt of one-time revenue from the sale of assets. More accurate revenue estimates will be available in May and June before the adoption of the Budget. The Governor has proposed \$167 million in tax reduction initiatives.

The Governor’s Budget proposes General Fund expenditures of \$68.8 billion. Included in the Budget are set-asides of \$500 million for legal contingencies and \$100 million for various one-time legislative initiatives. Based on the proposed revenues and expenditures, the Governor’s Budget projects the June 30, 2001 balance in the SFEU to be \$1.238 billion.

Summary of State Revenues and Expenditures

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE—GENERAL FUND (Budgetary Basis)(a) FISCAL YEARS 1996-97 THROUGH 2000-01 (Millions)

	1996-97	1997-98	1998-99	Estimated ^(b) 1999-00	Proposed ^(c) 2000-01
Fund Balance—Beginning of Period	\$ 1,073.9	\$ 639.8	\$ 2,792.5	\$ 3,907.7	\$ 3,012.4
Restatements					
Prior Year Revenue, Transfer					
Accrual Adjustments.....	(59.0)	(165.3)	(147.1)	(709.4)	--
Prior Year Expenditure, Accrual					
Adjustments.....	88.8	498.1	162.3	509.7	--
Fund Balance—Beginning of Period, as Restated	<u>\$ 1,103.7</u>	<u>\$ 972.6</u>	<u>\$ 2,807.7</u>	<u>\$ 3,708.0</u>	<u>\$ 3,012.4</u>
Revenues.....	\$49,161.4	\$54,797.7	\$58,935.1	\$64,819.0	\$68,250.3
Other Financing Sources					
Transfers from Other Funds.....	181.5	132.0	93.9	341.4	(13.7)
Other Additions.....	<u>49.3</u>	<u>154.4</u>	<u>339.4</u>	<u>--</u>	<u>--</u>
Total Revenues and Other Sources	<u>\$49,392.2</u>	<u>\$55,084.1</u>	<u>\$59,368.4</u>	<u>\$65,160.4</u>	<u>\$68,236.6</u>
Expenditures					
State Operations.....	\$12,151.5	\$14,042.1	\$14,775.8	\$15,667.3	\$16,562.9
Local Assistance.....	37,433.8	38,990.4	42,260.3	49,755.1	51,777.3
Capital Outlay.....	53.5	57.2	235.7	433.6	478.6
Unclassified.....	--	--	--	--	--
Other Uses					
Transfer to Other Funds.....	<u>217.3</u>	<u>174.5</u>	<u>996.6</u>	<u>--^(d)</u>	<u>--^(d)</u>
Total Expenditures and Other Uses	<u>\$49,856.1</u>	<u>\$53,264.2</u>	<u>\$58,268.4</u>	<u>\$65,856.0</u>	<u>\$68,818.8</u>
Revenues and Other Sources Over or (Under) Expenditures and Other Uses --	<u>\$ (463.9)</u>	<u>\$ 1,819.9</u>	<u>\$ 1,100.0)</u>	<u>\$ (695.6)</u>	<u>\$ (582.2)</u>
Fund Balance					
Reserved for Encumbrances.....	\$ 442.4	\$ 478.7	\$ 592.0	\$ 592.0	\$592.0
Reserved for Unencumbered Balances of Continuing Appropriations ^(e)	68.1	122.8	697.6	858.5	427.4
Reserved for School Loans ^(f)	1,459.7	1,259.7	1,009.7	699.7	349.7
Unreserved—Undesignated ^(g)	<u>(1,330.4)</u>	<u>931.3</u>	<u>1,608.4</u>	<u>862.2</u>	<u>1,061.1</u>
Fund Balance—End of Period	\$ 639.8	\$ 2,792.5	\$ 3,907.7	\$ 3,012.4	\$ 2,430.2

Footnotes on following page.

SOURCE: Fiscal Years 1996-97 to 1998-99: State of California, Office of the State Controller.
Fiscal Years 1999-00 and 2000-01: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with State law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The audited general purpose financial statements of the State contain a description of the differences between the budgetary basis and the GAAP basis of accounting. See "Financial Statements."

- (b) Estimates are shown net of reimbursements and abatements.
- (c) 2000-01 Proposed Governor's Budget, January 10, 2000. These projections are subject to completion of the legislative process to enact the 2000-01 budget.
- (d) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfer from Other Funds."
- (e) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2000-01 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement (\$1,222.2 million in 1998-99, \$858.5 million in 1999-00 and \$427.4 million in 2000-01). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the unencumbered balance for continuing appropriations.
- (f) During 1995, a reserve was established in the General Fund balance for the \$1.7 billion of previously recorded school loans which had been authorized by Chapter 703, Statutes of 1992 and Chapter 66, Statutes of 1993. These loans are deferred and are to be repaid from future General Fund appropriations. See "State Finances - Proposition 98" above for a discussion of the settlement of the CTA v. Gould lawsuit. This accounting treatment is consistent with the State's audited financial statements prepared in accordance with GAAP.
- (g) Includes Special Fund For Economic Uncertainties (SFEU). The State Controller reports the balance in the SFEU as of June 30, 1999, to be \$1,608.4 million in compliance with Government Code §16418(e) (see "State Finances – The Special Fund for Economic Uncertainties"). Therefore, the Undesignated-Unreserved fund balance at June 30, 1999, is \$0. The Department of Finance estimates a total SFEU balance of \$2,420 million on June 30, 2000, and a proposed balance of \$1,238 million on June 30, 2001. Additionally, the 2000-01 Governor's Budget includes set asides in 2000-01 in the amounts of \$500 million for legal contingencies and \$100 million for litigation.

Revenue and Expenditure Assumptions

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 1998-99 fiscal year and the Governor's Budget estimates for the 1999-00 and 2000-01 fiscal years.

<u>Source</u>	Revenues (Millions)			
	<u>Actual Fiscal Year 1998-99†</u>	<u>Original Fiscal Year 1999-00*</u>	<u>Revised Fiscal Year 1999-00†</u>	<u>Projected Fiscal Year 2000-01†</u>
Personal Income Tax.....	\$30,891	\$32,914	\$34,461	\$36,319
Sales and Use Tax.....	18,957	19,960	20,236	21,396
Bank and Corporation Tax.....	5,724	5,751	6,092	6,236
Insurance Tax.....	1,254	1,246	1,277	1,304
All Other.....	<u>1,789</u>	<u>3,110^(a)</u>	<u>3,094^(a)</u>	<u>2,982^(b)</u>
Total Revenues and Transfers	<u>\$58,615</u>	<u>\$62,981</u>	<u>\$65,160</u>	<u>\$68,237</u>

<u>Function</u>	Expenditures (Millions)			
	<u>Actual Fiscal Year 1998-99†</u>	<u>Original Fiscal Year 1999-00*</u>	<u>Revised Fiscal Year 1999-00†</u>	<u>Proposed Fiscal Year 2000-01†</u>
K-12 Education.....	\$23,528	\$26,418	\$26,366	\$28,014
Health and Human Services.....	16,063	16,921	17,842	18,920
Higher Education.....	7,402	8,012	7,945	8,775
Youth and Adult Correctional.....	4,547	4,739	4,868	5,054
Legislative, Judicial and Executive.....	1,888	2,195	2,319	2,395
Tax Relief.....	932	1,868	1,890	2,279
Resources.....	1,106	1,272	1,465	1,132
State and Consumer Services.....	442	482	493	485
Business, Transportation and Housing..	311	412	411	627
All Other.....	<u>1,608</u>	<u>1,414</u>	<u>2,257</u>	<u>1,138</u>
Total Expenditures	<u>\$57,827</u>	<u>\$63,733</u>	<u>\$65,856</u>	<u>\$68,819</u>

* 1999 Budget Act.

† 2000-01 Governor's Budget.

SOURCE: State of California, Department of Finance.

^(a) Includes \$517 million from tobacco litigation settlement payment.

^(b) Includes \$388 million from tobacco litigation settlement payment.

The Revenue and Expenditure assumptions set forth have been based upon certain estimates of the performance of the California and national economies in calendar years 2000 and 2001. In the Governor's Budget released on January 10, 2000, the Department of Finance projected that the California economy will continue to show strong growth in 2000, followed by more moderate gains in 2001. The projection also assumes continued growth in the stock market, although at lower rates than the past two years. The economic expansion has been marked by strong growth in high technology business services (including software, computer programming and the Internet), nonresidential construction, and tourism-related industries. The Asian economic crisis, which dampened growth in high technology manufacturing much of 1998 and 1999, appears to have ended. California-made exports advanced 10.2 percent in the third quarter of 1999 over the comparable 1998 period, led by a 48.5 percent increase in sales to East Asia (excluding Japan). As a result, employment in several electronics manufacturing industries began to recover in the latter months of 1999. Continued improvement in Asia, ongoing strength in NAFTA partners Mexico and Canada, and stronger growth in Europe are expected to further increase California-made exports in 2000 and 2001. Nonresidential construction has been strong for the past four years. New residential construction has increased since lows of the early 1990's recession, but remains lower than during the previous economic expansion in the 1980's.

The Department set out the following estimates for California's economic performance which were used in predicting revenues and expenditures for the Governor's 2000-01 Fiscal Year Budget. Also shown was the Department's previous forecast for 2000 and 2001, contained in the 1999-2000 May Revision.

	For 2000		For 2001	
	May <u>Revision*</u>	Governor's <u>Budget†</u>	May <u>Revision*</u>	Governor's <u>Budget†</u>
Nonfarm wage and salary employment (000)	14,393	14,478	14,649	14,845
Percent Change	2.5%	2.9%	1.8%	2.5%
Personal income (\$ billions)	\$1,013	\$1,026	\$1,061	\$1,085
Percent Change	5.4%	6.5%	4.7%	5.7%
Housing Permits (Units 000)	174	154	169	167
Consumer Price Index (% change)	2.7%	3.5%	2.6%	3.3%

* May Revision Forecast: May 14, 1999.

† Governor's Budget Forecast: January 10, 2000.

SOURCE: State of California, Department of Finance.

FINANCIAL STATEMENTS

Audited General Purpose Financial Statements of the State of California (the "Financial Statements") for the Year ended June 30, 1999, are attached as Exhibit 1 to this Appendix A. Such Financial Statements will be filed with all of the Nationally Recognized Municipal Securities Information Repositories, and are incorporated by reference into this Appendix. Potential investors may obtain or review a copy of the Financial Statements from the following sources:

1. By accessing the Internet Website of the State Controller (www.sco.ca.gov) and clicking on the icons for "Publications;" "State and Local Government Financial

Reports;” and “Comprehensive Annual Financial Report – 1999” in that order or by contacting the Office of the State Controller at (916) 445-2636.

2. By accessing the Internet Website of the State Treasurer (www.treasurer.ca.gov) and clicking on the icons for “Financial Information” and “Audited General Purpose Financial Statements” in that order, or by contacting the Office of the State Treasurer at (800) 900-3873.

Certain unaudited financial information for the 1999-2000 Fiscal Year is also included as Exhibit 2 to Appendix A.

ECONOMY AND POPULATION

Introduction

California’s economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. Since 1994, California’s economy has been performing strongly after suffering a deep recession between 1990-93.

Population and Labor Force

The State’s July 1, 1999 population of over 34 million represented over 12 percent of the total United States population.

California’s population is concentrated in metropolitan areas. As of the April 1, 1990 census, 96 percent resided in the 23 Metropolitan Statistical Areas in the State. As of July 1, 1998, the 5-county Los Angeles area accounted for 49 percent of the State’s population, with over 16.0 million residents, and the 10-county San Francisco Bay Area represented 21 percent, with a population of over 7.0 million.

The following table shows California’s population data for 1994 through 1999.

Population 1994-99

<u>Year</u>	<u>California Population^(a)</u>	<u>% Increase Over Preceding Year</u>	<u>United States Population^(a)</u>	<u>% Increase Over Preceding Year</u>	<u>California as % of United States</u>
1994	31,790,000	0.9%	260,292,000	1.0%	12.2%
1995	32,063,000	0.9	262,761,000	0.9	12.2
1996	32,383,000	1.0	265,179,000	0.9	12.2
1997	32,957,000	1.8	267,636,000	0.9	12.3
1998	33,494,000	1.6	270,248,000	1.0	12.4
1999	34,036,000	1.6	272,691,000	0.9	12.5

^(a) Population as of July 1.

SOURCE: U.S. Department of Commerce, Bureau of the Census; State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1993 to 1999.

**Labor Force
1993-99**

<u>Year</u>	<u>Labor Force Trends (Thousands)</u>		<u>Unemployment Rate (%)</u>	
	<u>Labor Force</u>	<u>Employment</u>	<u>California</u>	<u>United States</u>
1993	15,359	13,918	9.4%	6.9%
1994	15,450	14,122	8.6	6.1
1995	15,412	14,203	7.8	5.6
1996	15,511	14,391	7.2	5.4
1997	15,941	14,937	6.3	4.9
1998	16,330	15,361	5.9	4.5
1999 p/	16,583	15,704	5.3	4.2

p/ Preliminary

SOURCE: State of California, Employment Development Department.

Employment, Income, Construction and Export Growth

The following table shows California's nonagricultural employment distribution and growth for 1990 and 1999.

**Payroll Employment By Major Sector
1990 and 1999**

<u>Industry Sector</u>	<u>Employment (Thousands)</u>		<u>% Distribution of Employment</u>	
	<u>1990</u>	<u>1999</u>	<u>1990</u>	<u>1999</u>
Mining.....	38.9	23.8	0.3%	0.2%
Construction.....	605.3	655.7	4.8	4.74
Manufacturing				
Nondurable goods	720.6	739.4	5.7	5.34
High Technology.....	686.0	513.4	5.4	3.7
Other Durable Goods.....	690.3	696.9	5.5	5.0
Transportation and Utilities.....	623.9	715.3	4.9	5.1
Wholesale and Retail Trade	3,002.2	3,176.0	23.7	22.7
Finance, Insurance				
And Real Estate	824.6	812.1	6.5	5.8
Services	3,395.3	4,418.1	26.8	31.6
Government				
Federal.....	362.1	264.0	2.9	1.9
State and Local.....	<u>1,712.7</u>	<u>1,960.8</u>	<u>13.5</u>	<u>14.0</u>
TOTAL				
NONAGRICULTURAL.....	<u>12,661.9</u>	<u>13,975.3</u>	<u>100</u>	<u>100</u>

*May not add to total due to rounding.

SOURCE: State of California, Employment Development Department and State of California, Department of Finance.

The following tables show California's total and per capita income patterns for selected years.

Total Personal Income 1993-99

<u>California</u>			
<u>Year</u>	<u>Millions</u>	<u>% Change</u>	<u>California % of U.S.</u>
1993.....	\$698,130	2.0%*	12.8%
1994 ^a	718,321	2.9	12.5
1995.....	754,269	5.0	12.4
1996.....	798,020	5.8	12.5
1997.....	846,017	6.0	12.5
1998 ^b	904,444	6.9	12.7
1999 ^f	963,800	6.6	12.9

* Change from prior year.

^a Reflects Northridge earthquake, which caused an estimated \$15 billion drop in personal income.

^b Estimated by the State of California, Department of Finance.

^f Governor's Budget Forecast, November 1999.

Note: Omits income for government employees overseas.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

Per Capita Personal Income 1993-99

<u>Year</u>	<u>California</u>	<u>% Change</u>	<u>United States</u>	<u>% Change</u>	<u>California % of U.S.</u>
1993.....	\$22,388	1.0%*	\$21,220	3.3%*	105.5%
1994 ^a	22,899	2.3	22,056	3.9	103.8
1995.....	23,901	4.4	23,063	4.6	103.6
1996.....	25,050	4.8	24,169	4.8	103.6
1997.....	26,218	4.7	25,298	4.7	103.6
1998.....	27,116 ^b	3.4	26,368 ^c	4.2	102.8
1999 ^c	28,432	4.9	27,485	5.2	103.4

* Change from prior year

^a Reflects Northridge earthquake, which caused an estimated \$15 billion drop in personal income.

^b Estimated by the State of California, Department of Finance.

^c Estimated by the U.S. Department of Commerce, Bureau of Economic Analysis.

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.

The following tables show California's residential and nonresidential construction authorized by permits for selected years.

Residential Construction Authorized by Permits

<u>Year</u>	<u>Units</u>			<u>Valuation a/ (\$ mill.)</u>
	<u>Total</u>	<u>Single</u>	<u>Multiple</u>	
1994	97,047	77,115	19,932	\$14,852
1995	85,293	68,689	16,604	13,879
1996	94,283	74,923	19,360	15,289
1997	111,716	84,780	26,936	18,752
1998	125,707	94,298	31,409	21,976
1999	139,473	101,399	38,074	25,677

a/ Valuation includes additions and alterations.

SOURCE: Construction Industry Research Board

Nonresidential Construction (Thousands of dollars)

<u>Year</u>	<u>Commercial</u>	<u>Industrial</u>	<u>Other</u>	<u>Additions and Alterations</u>	<u>Total</u>
1994	\$2,108,067	\$ 649,632	\$1,051,276	\$4,080,657	\$ 7,889,632
1995	2,308,912	732,877	1,050,684	4,062,271	8,154,744
1996	2,751,909	1,140,575	1,152,425	4,539,219	9,584,128
1997	4,271,378	1,598,428	1,378,220	5,021,792	12,269,818
1998	5,419,251	2,466,530	1,782,337	5,307,901	14,976,019
1999	5,639,026	2,251,251	2,341,374	6,258,103	16,489,754

SOURCE: Construction Industry Research Board

The following tables show California's export growth for the period from 1993 through 1998.

Exports Through California Ports (In millions)

<u>Year</u>	<u>Exports ^{a/}</u>	<u>% Change</u>
1994	\$ 95,614.6	16.4%
1995	116,825.5	22.2
1996	124,120.0	6.2
1997	131,142.7	5.7
1998	116,282.4	-11.3
1999 ^{b/}	122,092.8	5.0

a/ "free along ship" Value Basis

b/Preliminary estimates.

SOURCE: U.S. Department of Commerce, Bureau of the Census

LITIGATION

The State is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "Litigation" in the main body of this Official Statement.

On December 24, 1997, a consortium of California counties filed a test claim with the Commission on State Mandates (the "Commission") asking the Commission to determine whether the property tax shift from counties to school districts beginning in 1993-94, is a reimbursable state mandated cost. See "State Finances – Local Governments" above. The test claim was heard on October 29, 1998, and the Commission on State Mandates found in favor of the State. In October 1999, the Superior Court of Sonoma County overturned the Commission's decision. The State has appealed, and briefing will be completed by the end of June 2000. Should the final decision on this matter be in favor of the counties, the impact to the State General Fund could be as high as \$10.0 billion. In addition, there would be an annual Proposition 98 General Fund cost of at least \$3.75 billion. This cost would grow in accordance with the annual assessed value growth rate.

On June 24, 1998, plaintiffs in *Howard Jarvis Taxpayers Association et al. v. Kathleen Connell* filed a complaint for certain declaratory and injunctive relief challenging the authority of the State Controller to make payments from the State Treasury in the absence of a state budget. On July 21, 1998, the trial court issued a preliminary injunction prohibiting the State Controller from paying moneys from the State Treasury for fiscal year 1998-99, with certain limited exceptions, in the absence of a state budget. The preliminary injunction, among other things, prohibited the State Controller from making any payments pursuant to any continuing appropriation. On July 22 and 27, 1998, various employee unions which had intervened in the case appealed the trial court's preliminary injunction and asked the Court of Appeal to stay the preliminary injunction. On July 28, 1998, the Court of Appeal granted the unions' requests and stayed the preliminary injunction pending the Court of Appeal's decision on the merits of the appeal. On August 5, 1998, the Court of Appeal denied the plaintiffs' request to reconsider the stay. Also on July 22, 1998, the State Controller asked the California Supreme Court to immediately stay the trial court's preliminary injunction and to overrule the order granting the preliminary injunction on the merits. On July 29, 1998, the Supreme Court transferred the State Controller's request to the Court of Appeal. The matters are now pending before the Court of Appeal. Briefs have been submitted; no date has yet been set for oral argument.

The State is involved in a lawsuit, *Thomas Hayes v. Commission on State Mandates*, related to state-mandated costs. The action involves an appeal by the Director of Finance from a 1984 decision by the State Board of Control (now succeeded by the Commission). The Board of Control decided in favor of local school districts' claims for reimbursement for special education programs for handicapped students. The case was then brought to the trial court by the State and later remanded to the Commission for redetermination. The Commission has since expanded the claim to include supplemental claims filed by several other institutions. To date, the Legislature has not appropriated funds. The Commission issued a decision in December 1998 determining that a small number of components of the State's special education program are state mandated local costs. The administrative proceeding is in the "parameters and guidelines" stage where the Commission is considering whether and to what extent the costs associated with the state

mandated components of the special education program are offset by funds that the State already allocates to that program. The State's position is that all costs are offset by existing funding. The State has the option to seek judicial review of the mandate finding. Potential liability of the State, if all potentially eligible school districts pursue timely claims, has been estimated by the Department of Finance to be in excess of \$1.5 billion, if the State is not credited for its existing funding of the program.

In January of 1997, California experienced major flooding with preliminary estimates of property damage of approximately \$1.6 to \$2.0 billion. In *McMahon v. State*, a substantial number of plaintiffs have joined suit against the State, local agencies, and private companies and contractors seeking compensation for the damages they suffered as a result of the 1997 flooding. After various pre-trial proceedings, the State filed its answer to the plaintiffs' complaint in January of 2000. No trial date has been set. The State is vigorously defending the action.

The State is a defendant in *Ceridian Corporation v. Franchise Tax Board*, which challenges the constitutionality of a Revenue & Taxation Code section which limits deductions for insurance dividends to those dividends paid from earnings previously subject to California taxation. On August 13, 1998, the trial court issued a judgment against the Franchise Tax Board. The Franchise Tax Board has appealed the judgment. Briefing has been completed. The State has taken the position that, if the challenged section of the Revenue & Taxation Code is struck down, all deductions relating to dividends would be eliminated and the result would be additional income to the State. Plaintiffs, however, contend that if they prevail, the deduction should be extended to all dividends which would result in a one-time liability for open years of approximately \$60 million, including interest, and an annual revenue loss of approximately \$10 million.

The State is also a defendant in *First Credit Bank etc. v. Franchise Tax Board* which challenges a Revenue & Taxation Code section similar to the one challenged in the *Ceridian* case, but applicable to a different group of corporate taxpayers. The State's motion for summary judgment is currently pending and a trial date has been set in April 2000. A decision in the *Ceridian* case could impact the outcome of this case. The State has taken the position that, if the challenged section of the Revenue & Taxation Code is struck down, all deductions relating to dividends would be eliminated and the result would be additional income to the State. Plaintiffs, however, contend that if they prevail, the deduction should be extended to all dividends which would result in a one-time liability for open years of approximately \$385 million, including interest, and an annual revenue loss of approximately \$60 million.

The State is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, People of the State of California v. J.B. Stringfellow, Jr., et al.*, the State is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. However, the defendants have filed a counterclaim against the State for alleged negligent acts, resulting in significant findings of liability against the State as owner, operator, and generator of wastes taken to the site. The State has appealed the rulings. Present estimates of the cleanup range from \$400 million to \$600 million. Potential State liability falls within this same range. However, all or a portion of any judgment against the State could be satisfied by recoveries from

the State's insurance carriers. The State has filed a suit against certain of these carriers. The trial is expected to begin in early 2001.

The State is a defendant in *Paterno v. State of California*, a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court found liability in inverse condemnation and awarded damages of \$500,000 to a sample of plaintiffs. The State's potential liability to the remaining plaintiffs ranges from \$800 million to \$1.5 billion. In 1992, the State and plaintiffs filed appeals. In August 1999, the Court of Appeal issued a decision reversing the trial court's judgment against the State and remanding the case for retrial on the inverse condemnation cause of action. The California Supreme Court denied plaintiffs' petition for review. No trial date has been set.

Plaintiffs in *County of San Bernardino v. Barlow Respiratory Hospital* and related actions seek mandamus relief requiring the State to retroactively increase out-patient Medi-Cal reimbursement rates. Plaintiffs have estimated the damages to be several hundred million dollars. The State is vigorously defending these cases, as well as related federal cases addressing the calculation of Medi-Cal reimbursement rates in the future.

The State is involved in two refund actions, *Cigarettes Cheaper!, et al. v. Board of Equalization, et al.* and *California Assn. Of Retail Tobacconists (CART), et al. v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10, approved by the voters in 1998. Plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. Plaintiffs *Cigarettes Cheaper!* seek declaratory and injunctive relief and a refund of over \$4 million. The *CART* case filed by retail tobacconists in San Diego seeks a refund of \$5 million. The State is vigorously contesting these cases. If the statute is declared unconstitutional, exposure may include the entire \$750 million collected annually with interest.

The State is involved in two cases challenging the constitutionality of the interest offset provisions of the Revenue and Taxation Code: *Hunt-Wesson, Inc., v. Franchise Tax Board* and *F.W. Woolworth Co. and Kinney Shoe Corporation v. Franchise Tax Board*. In both cases, the Franchise Tax Board prevailed in California Court of Appeal and the California Supreme Court denied taxpayers' petitions for review. In both cases, the United States Supreme Court granted certiorari. On February 22, 2000, the United States Supreme Court reversed and remanded the *Hunt-Wesson* case to the California Court of Appeal for further proceedings. Although the Court did not take similar action in the *Woolworth Co.* case, it is anticipated that it will do so. The Franchise Tax Board recently estimated that the adverse decisions in these cases will result in a reduction in state revenues of approximately \$15 million annually, with past year collection and interest exposure of approximately \$95 million.

Guy F. Atkinson Company of California v. Franchise Tax Board is a corporation tax refund action involving the solar energy system tax credit provided for under the Revenue & Taxation Code. The case went to trial in May 1998 and the trial court entered judgment in favor of the Franchise Tax Board. The taxpayer has filed an appeal to the California Court of Appeal and briefing is completed. The Franchise Tax Board estimates that the cost would be \$150 million annually if the plaintiff prevails. Allowing refunds for all open years would entail a refund of at least \$500 million.

Jordan, et al. v. Department of Motor Vehicles, et al., challenges the validity of the Vehicle Smog Impact Fee, a \$300 fee which is collected by the Department of Motor Vehicles from vehicle registrants when a vehicle without a California new-vehicle certification is first registered in California. The plaintiffs contend that the fee violates the interstate commerce and equal protection clauses of the United States Constitution as well as Article XIX of the State Constitution. In October, 1999 the Court of Appeal upheld a trial court judgment for the plaintiffs and the State has declined to appeal further. Although refunds through the court actions could be limited by a three-year statute of limitations, with a potential liability of about \$350 million, the Governor has proposed refunding fees collected back to the initiation of these fees in 1990. The 2000-01 Governor's Budget proposes expenditures of \$562 million as a supplemental appropriation in 1999-2000 to pay these claims (see "Current State Budget -- 1999-2000 Fiscal Year Budget").

PTI, Inc., et al. v. Philip Morris, et al. was filed by five distributors in the cigarette import/re-entry business, seeking to overturn the tobacco Master Settlement Agreement (MSA) entered between 46 states and the tobacco industry in November, 1998. See "State Finances -- Tobacco Litigation" above. The primary focus of the complaint is the provision of the MSA encouraging participating states to adopt a statute requiring nonparticipating manufacturers to either become participating manufacturers and share the financial obligations under the MSA or pay money into an escrow account. Plaintiffs seek compensatory and punitive damages against the state and state officials and an order placing tobacco settlement funds into a trust to be administered by the court for the treatment of medical expenses of persons injured by tobacco products. Plaintiffs have filed an amended complaint and the State has filed a motion to dismiss the amended complaint. A hearing on the State's motion to dismiss is set for May 8, 2000. The potential fiscal impact of an adverse ruling is largely unknown, but could exceed the full amount of the settlement (estimated to be \$1 billion annually, of which 50 percent will go directly to the State's General Fund and the other 50 percent directly to the State's 58 counties and 4 largest cities).

In *FORCES Action Project et al. v. State of California et al.*, various smokers rights groups challenge the tobacco settlement as it pertains to California, Utah and the City and County of San Francisco. Plaintiffs assert a variety of constitutional challenges, including that the settlement represents an unlawful tax on smokers. Motions to dismiss by all defendants, including the tobacco companies, were eventually converted to summary judgment motions by the court and heard on September 17, 1999. On January 5, 2000, the court dismissed the complaint for lack of subject matter jurisdiction because the plaintiffs lacked standing to sue. The court also concluded that the plaintiffs' claims against the State and its officials are barred by the 11th Amendment. Plaintiffs have appealed. Briefing is expected to be complete by July, 2000.

Louis Bolduc et al. v. State of California et al. is a class action filed on July 13, 1999 by six Medi-Cal beneficiaries who have received medical treatment for smoking-related diseases. Plaintiffs allege the State owes them an unspecified portion of the tobacco settlement monies under a federal regulation that requires a state to turn over to an injured Medicaid beneficiary any monies the state recovers from a third party tortfeasor in excess of the costs of the care provided. The State moved to dismiss the complaint on September 8, 1999. On February 29, 2000, the

court denied the State's motion to dismiss, but struck the Plaintiffs' class action allegations. The State intends to appeal that portion of the court's order denying its motion to dismiss.

Arnett v. California Public Employees Retirement System, et. al. was filed by seven former employees of the State of California and local agencies, seeking back wages, damages and injunctive relief. Plaintiffs are former public safety members who began employment after the age of 40 and are recipients of Industrial Disability Retirement ("IDR") benefits. Plaintiffs contend that the formula which determines the amount of IDR benefits violates the federal Age Discrimination in Employment Act of 1967 ("ADEA"). Plaintiffs contend that, but for their ages at hire, they would receive increased monthly IDR benefits similar to their younger counterparts who began employment before the age of 40. CalPERS has estimated the liability to the State as approximately \$315.5 million were the plaintiffs to prevail. The District Court dismissed the complaint for failure to state a claim. On August 17, 1999, the Ninth Circuit Court of Appeals reversed the District Court's dismissal of the complaint. The State sought further review in the United States Supreme Court. On January 11, 2000, the United States Supreme Court in *Kimel v. Florida Board of Regents*, held that Congress did not abrogate the sovereign immunity of the states when it enacted the ADEA. Thereafter, on January 18, 2000, the Supreme Court granted the petition for writ of certiorari in *Arnett*, vacated the judgment of the Ninth Circuit, and remanded the case to the Ninth Circuit for further proceedings consistent with *Kimel*. It now appears that the District Court will dismiss the State Defendants from the lawsuit.

STATE DEBT TABLES

The tables which follow provide information on outstanding State debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for State general obligation and lease-purchase bonds, and authorized and outstanding State revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the State expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the State to pay principal and interest on the bonds from the General Fund.

These tables are updated on a quarterly basis. The tables which follow do not include the issuance of the following bonds: \$500,000,000 of State General Obligation Bonds on March 2, 2000. As of March 1, 2000, outstanding General Obligation Commercial Paper Notes (net of Notes to be retired from the proceeds of General Obligation Bonds issued on March 2, 2000) totaled \$638,565,000.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of February 1, 2000

	Voter Authorization		Bonds Outstanding	CP Program Authorized (a)	Unissued (b)
	Date	Amount			
GENERAL FUND BONDS (Non-Self Liquidating)					
California Earthquake Safety and Housing Rehabilitation Bond Act of 1988.....	6/7/88	\$ 150,000	\$ 95,510	\$ n.a.	0
California Library Construction and Renovation Bond Act of 1988.....	11/8/88	75,000	52,475	1,225	1,900
California Park and Recreational Facilities Act of 1984.....	6/5/84	370,000	188,645	n.a.	1,100
California Parklands Act of 1980.....	11/4/80	285,000	58,985	n.a.	0
California Safe Drinking Water Bond Law of 1976.....	6/8/76	175,000	62,955	n.a.	2,500
California Safe Drinking Water Bond Law of 1984.....	11/6/84	75,000	37,390	n.a.	0
California Safe Drinking Water Bond Law of 1986.....	11/4/86	100,000	67,135	n.a.	6,000
California Safe Drinking Water Bond Law of 1988.....	11/8/88	75,000	53,165	6,265	2,000
California Wildlife, Coastal, and Park Land Conservation Act of 1988.....	6/7/88	776,000	516,560	n.a.	14,980
Class Size Reduction Public Education Facilities Bond Act of 1998 (Hi Ed).....	11/3/98	2,500,000	38,500	367,500	2,094,000
Class Size Reduction Public Education Facilities Bond Act of 1998 (K-12).....	11/3/98	6,700,000	1,121,700	2,228,300	3,350,000
Clean Air and Transportation Improvement Bond Act of 1990.....	6/5/90	1,990,000	1,126,240	242,925	333,300
Clean Water and Water Conservation Bond Law of 1978.....	6/6/78	375,000	76,390	n.a.	0
Clean Water and Water Reclamation Bond Law of 1988.....	11/8/88	65,000	49,945	0	0
Clean Water Bond Law of 1970.....	11/3/70	250,000	5,500	n.a.	0
Clean Water Bond Law of 1974.....	6/4/74	250,000	11,260	n.a.	0
Clean Water Bond Law of 1984.....	11/6/84	325,000	115,165	n.a.	0
Community Parklands Act of 1986.....	6/3/86	100,000	56,245	n.a.	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.....	11/8/88	500,000	331,420	7,880	0
County Correctional Facility Capital Expenditure Bond Act of 1986.....	6/3/86	495,000	285,850	n.a.	0
County Jail Capital Expenditure Bond Act of 1981.....	11/2/82	280,000	103,675	n.a.	0
County Jail Capital Expenditure Bond Act of 1984.....	6/5/84	250,000	97,000	n.a.	0
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990.....	6/5/90	300,000	106,555	42,000	135,000
Fish and Wildlife Habitat Enhancement Act of 1984.....	6/5/84	85,000	39,540	n.a.	3,000
Hazardous Substance Cleanup Bond Act of 1984.....	11/6/84	100,000	39,590	n.a.	0
Higher Education Facilities Bond Act of 1986.....	11/4/86	400,000	199,200	n.a.	0
Higher Education Facilities Bond Act of 1988.....	11/8/88	600,000	331,005	4,705	7,000
Higher Education Facilities Bond Act of June 1990.....	6/5/90	450,000	281,120	5,000	3,000
Higher Education Facilities Bond Act of June 1992.....	6/2/92	900,000	713,480	13,410	12,700
Housing and Homeless Bond Act of 1988.....	11/8/88	300,000	114,010	n.a.	0
Housing and Homeless Bond Act of 1990.....	6/5/90	150,000	80,365	n.a.	0
Lake Tahoe Acquisitions Bond Act.....	8/2/82	85,000	42,310	n.a.	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS (Continued)

	Voter Authorization		Bonds		CP Program	
	Date	Amount	Outstanding	Authorized (a)	Unissued (b)	
New Prison Construction Bond Act of 1981.....	6/8/82	\$ 495,000	\$ 130,750	\$ n.a.	\$ 0	
New Prison Construction Bond Act of 1984.....	6/5/84	300,000	92,500	n.a.	0	
New Prison Construction Bond Act of 1986.....	11/4/86	500,000	266,680	n.a.	1,500	
New Prison Construction Bond Act of 1988.....	11/8/88	817,000	456,530	7,600	8,400	
New Prison Construction Bond Act of 1990.....	6/5/90	450,000	276,335	20,100	0	
Passenger Rail and Clean Air Bond Act of 1990.....	6/5/90	1,000,000	671,645	24,900	0	
Public Education Facilities Bond Act of 1996.....	3/26/96	3,000,000	2,433,480	357,105	60,700	
1988 School Facilities Bond Act.....	11/8/88	800,000	473,120	7,000	0	
1990 School Facilities Bond Act.....	6/5/90	800,000	492,805	3,745	0	
1992 School Facilities Bond Act.....	11/3/92	900,000	696,851	15,094	0	
Safe, Clean Reliable Water Supply Act of 1996.....	11/5/96	995,000	198,370	84,000	707,000	
Seismic Retrofit Bond Act of 1996.....	3/26/96	2,000,000	913,945	595,145	448,000	
School Building and Earthquake Bond Act of 1974.....	11/5/74 (c)	40,000	35,995	n.a.	0	
School Facilities Bond Act of 1988.....	6/7/88	800,000	434,255	n.a.	0	
School Facilities Bond Act of 1990.....	11/6/90	800,000	517,680	8,500	0	
School Facilities Bond Act of 1992.....	6/2/92	1,900,000	1,348,235	53,900	0	
Senior Center Bond Act of 1984.....	11/6/84	50,000	17,250	n.a.	0	
State Beach, Park, Recreational and Historical Facilities Bonds.....	6/4/74	250,000	2,355	n.a.	0	
State School Building Lease-Purchase Bond Law of 1982.....	11/2/82	500,000	98,550	n.a.	0	
State School Building Lease-Purchase Bond Law of 1984.....	11/6/84	450,000	192,100	n.a.	0	
State School Building Lease-Purchase Bond Law of 1986.....	11/4/86	800,000	426,300	n.a.	0	
State, Urban, and Coastal Park Bond Act of 1976.....	11/2/76	280,000	21,705	n.a.	0	
Water Conservation and Water Quality Bond Law of 1986.....	6/3/86	150,000	72,605	n.a.	39,500	
Water Conservation Bond Law of 1988.....	11/8/88	60,000	35,885	13,435	3,000	
Total General Fund Bonds.....		\$ 37,668,000	\$ 16,804,811	\$ 4,109,734	\$ 7,234,580	
ENTERPRISE FUND BONDS (Self Liquidating)						
California Water Resources Development Bond Act of 1959.....	11/8/60	\$ 1,750,000	\$ 960,710	\$ n.a.	\$ 167,600	
State School Building Aid and Earthquake Reconstruction and Replacement Bond Law of 1974.....	11/5/74 (c)	110,000	1,250	n.a.	0	
Veterans Bonds.....	(d)	5,610,000	2,616,230	14,000	176,835	
Total Enterprise Fund Bonds.....		\$ 7,470,000	\$ 3,578,190	\$ 14,000	\$ 344,435	
TOTAL GENERAL OBLIGATION BONDS.....		\$ 45,138,000	\$ 20,383,001	\$ 4,123,734	\$ 7,579,015	

(a) Total commercial paper authorized to be issued by the respective Finance Committees. Of this total \$959,565,000 is outstanding as of February 1, 2000.
Pursuant to terms of the Finance Committee resolutions, no more than \$1.5 billion of commercial paper can be outstanding at any one time.
Bond acts marked "n.a." are not legally permitted to utilize commercial paper, or all bonds were issued before the commercial paper program began.

(b) Treats full commercial paper authorization as issued; see footnote (a).

(c) Pursuant to Prop 203, passed by the voters in the March 26, 1996 primary election, \$40 million in bonds unissued at that time became general fund supported, while all previously issued bonds will remain under "State School Building Aid Bonds" as self-liquidating Enterprise Bonds.

(d) Various dates.

SOURCE: State of California, Office of the Treasurer.

OUTSTANDING STATE DEBT
FISCAL YEARS 1994-95 THROUGH 1998-99
(Dollars in Thousands Except for Per Capita Information)

	<u>1994-95</u>	<u>1995-96</u>	<u>1996-97</u>	<u>1997-98</u>	<u>1998-99</u>
Outstanding Debt(a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating).....	\$ 14,903,326	\$ 14,322,086	\$ 14,250,536	\$ 14,932,766	\$ 16,202,211
Enterprise Fund (Self Liquidating).....	4,171,775	3,934,630	3,699,060	3,906,950	3,674,020
Total.....	\$ 19,075,101	\$ 18,256,716	\$ 17,949,596	\$ 18,839,716	\$ 19,876,231
Lease-Purchase Debt.....	5,565,162	5,845,237	6,175,044	6,639,620	6,671,534
Total Outstanding General Obligation Bonds and Lease-Purchase Debt.....	\$ 24,640,263	\$ 24,101,953	\$ 24,124,640	\$ 25,479,336	\$ 26,547,765
Bond Sales During Fiscal Year					
Non-Self Liquidating General Obligation Bonds.....	\$ 1,505,600	\$ 620,810	\$ 1,025,000	\$ 1,667,820	\$ 2,294,650
Self Liquidating General Obligation Bonds.....	\$ 386,930	\$ 0	\$ 0	\$ 447,535	\$ 80,000
Lease-Purchase Debt.....	\$ 598,817	\$ 779,575	\$ 1,257,630	\$ 1,245,190	\$ 456,410
Debt Service(b)					
Non-Self Liquidating General Obligation Bonds.....	\$ 1,901,265	\$ 1,960,603	\$ 1,946,333	\$ 1,878,026	\$ 1,934,628
	\$ 425,940	\$ 482,751	\$ 532,783	\$ 577,987	\$ 652,131
General Fund Receipts(b)	\$ 44,547,812	\$ 46,731,104	\$ 49,831,217	\$ 55,261,557	\$ 58,510,860
Non-Self Liquidating General Obligation Bonds					
Debt Service as a Percentage of General Fund Receipts.....	4.27%	4.20%	3.91%	3.40%	3.31%
Lease-Purchase Debt Service as a Percentage of General Fund Receipts.....	0.96%	1.03%	1.07%	1.05%	1.11%
Population(c)	31,790,000	32,063,000	32,383,000	32,957,000	33,494,000
Non-Self Liquidating General Obligation Bonds					
Outstanding Per Capita.....	\$ 468.81	\$ 446.69	\$ 440.06	\$ 453.10	\$ 483.73
Lease-Purchase Debt Outstanding Per Capita.....	\$ 175.06	\$ 182.30	\$ 190.69	\$ 201.46	\$ 199.19
Personal Income(d)	\$ 754,269,000	\$ 798,020,000	\$ 846,017,000	\$ 905,140,000	\$ 961,600,000
Non-Self Liquidating General Obligation Bonds					
Outstanding as Percentage of Personal Income.....	1.98%	1.79%	1.68%	1.65%	1.68%
Lease-Purchase Debt Outstanding as Percentage of Personal Income.....	0.74%	0.73%	0.73%	0.73%	0.69%

(a) As of last day of fiscal year

(b) Calculated on a cash basis; debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.

(c) As of July 1, the beginning of the fiscal year.

(d) Calendar year in which fiscal year ends; 1998 & 1999 estimated.

SOURCES: Population and Personal Income: State of California, Department of Finance

Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.

General Fund Receipts: State of California, Office of the State Controller.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND GENERAL OBLIGATION BONDS(a)
(Non-Self Liquidating)
As of February 1, 2000**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (b)	Total
2000.....	\$ 390,943,845.25	\$ 285,195,000.00	\$ 676,138,845.25 (c)
2001.....	946,597,988.00	1,140,473,068.25	2,087,071,056.25
2002.....	870,331,637.57	1,184,445,000.00	2,054,776,637.57
2003.....	800,581,380.14	1,133,766,391.80	1,934,347,771.94
2004.....	730,019,287.95	1,059,820,000.00	1,789,839,287.95
2005.....	668,980,888.84	996,759,388.71	1,665,740,277.55
2006.....	605,912,718.75	933,405,000.00	1,539,317,718.75
2007.....	548,030,903.02	888,805,000.00	1,436,835,903.02
2008.....	496,771,339.18	871,803,078.31	1,368,574,417.49
2009.....	443,286,118.75	862,590,000.00	1,305,876,118.75
2010.....	390,874,000.50	793,490,000.00	1,184,364,000.50
2011.....	344,672,366.09	712,784,045.16	1,057,456,411.25
2012.....	298,591,111.30	570,190,000.00	868,781,111.30
2013.....	267,941,293.75	459,295,000.00	727,236,293.75
2014.....	245,560,110.89	383,855,000.00	629,415,110.89
2015.....	226,726,330.94	372,430,000.00	599,156,330.94
2016.....	207,640,065.74	370,145,000.00	577,785,065.74
2017.....	187,838,987.56	370,220,000.00	558,058,987.56
2018.....	168,836,324.73	369,500,000.00	538,336,324.73
2019.....	149,722,748.50	368,465,000.00	518,187,748.50
2020.....	130,773,492.25	364,765,000.00	495,538,492.25
2021.....	112,924,849.75	363,440,000.00	476,364,849.75
2022.....	94,838,464.75	347,170,000.00	442,008,464.75
2023.....	76,237,335.20	349,490,000.00	425,727,335.20
2024.....	59,574,901.59	279,750,000.00	339,324,901.59
2025.....	45,708,824.08	240,400,000.00	286,108,824.08
2026.....	33,612,793.34	202,620,000.00	236,232,793.34
2027.....	23,179,637.09	185,980,000.00	209,159,637.09
2028.....	14,105,153.59	168,480,000.00	182,585,153.59
2029.....	6,795,175.00	117,275,000.00	124,070,175.00
2030.....	1,623,331.25	58,005,000.00	59,628,331.25
Total	\$ 9,589,233,405.34	\$ 16,804,810,972.23	\$ 26,394,044,377.57

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from March 1, 2000 through June 30, 2000.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR ENTERPRISE FUND GENERAL OBLIGATION BONDS(a)
(Self Liquidating)
As of February 1, 2000**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (b)	Total
2000.....	\$ 79,352,468.89	\$ 36,990,000.00	\$ 116,342,468.89 (c)
2001.....	207,615,778.75	138,510,000.00	346,125,778.75
2002.....	197,167,943.75	141,975,000.00	339,142,943.75
2003.....	186,595,993.85	142,075,000.00	328,670,993.85
2004.....	175,657,646.25	165,340,000.00	340,997,646.25
2005.....	164,009,577.25	178,090,000.00	342,099,577.25
2006.....	151,976,139.75	161,805,000.00	313,781,139.75
2007.....	140,480,498.51	175,695,000.00	316,175,498.51
2008.....	128,385,764.80	173,755,000.00	302,140,764.80
2009.....	116,730,220.00	173,375,000.00	290,105,220.00
2010.....	105,555,047.80	168,345,000.00	273,900,047.80
2011.....	95,797,720.77	123,770,000.00	219,567,720.77
2012.....	88,384,759.75	163,330,000.00	251,714,759.75
2013.....	80,239,774.37	163,820,000.00	244,059,774.37
2014.....	73,048,287.95	130,035,000.00	203,083,287.95
2015.....	66,796,580.65	128,845,000.00	195,641,580.65
2016.....	60,163,503.25	134,245,000.00	194,408,503.25
2017.....	53,594,327.73	125,925,000.00	179,519,327.73
2018.....	47,497,032.84	105,525,000.00	153,022,032.84
2019.....	41,950,326.71	101,560,000.00	143,510,326.71
2020.....	37,342,091.80	66,830,000.00	104,172,091.80
2021.....	33,535,613.79	61,000,000.00	94,535,613.79
2022.....	29,986,592.39	57,540,000.00	87,526,592.39
2023.....	26,557,193.75	39,000,000.00	65,557,193.75
2024.....	24,295,262.50	41,330,000.00	65,625,262.50
2025.....	21,899,368.75	43,730,000.00	65,629,368.75
2026.....	19,356,062.50	70,860,000.00	90,216,062.50
2027.....	15,664,506.25	54,620,000.00	70,284,506.25
2028.....	12,489,395.00	15,500,000.00	27,989,395.00
2029.....	11,440,123.75	21,755,000.00	33,195,123.75
2030.....	10,341,567.50	17,235,000.00	27,576,567.50
2031.....	9,450,925.00	13,930,000.00	23,380,925.00
2032.....	8,622,635.00	14,740,000.00	23,362,635.00
2033.....	4,098,395.00	227,110,000.00	231,208,395.00
Total	\$ 2,526,079,126.60	\$ 3,578,190,000.00	\$ 6,104,269,126.60

(a) Does not include commercial paper outstanding.

(b) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(c) Total represents the remaining debt service requirements from March 1, 2000 through June 30, 2000.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-PURCHASE DEBT
As of February 1, 2000**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (a)	Total
2000.....	\$ 165,439,712.39	\$ 76,425,000.00	\$ 241,864,712.39 (b)
2001.....	351,339,937.31	316,464,019.75	667,803,957.06
2002.....	336,584,569.51	297,175,773.02	633,760,342.53
2003.....	324,626,919.26	302,801,118.58	627,428,037.84
2004.....	308,869,088.79	310,781,386.24	619,650,475.03
2005.....	294,405,786.55	324,634,507.20	619,040,293.75
2006.....	275,341,320.93	343,527,554.60	618,868,875.53
2007.....	262,691,322.59	295,868,920.44	558,560,243.03
2008.....	244,571,824.54	303,031,787.98	547,603,612.52
2009.....	232,805,560.68	324,007,732.44	556,813,293.12
2010.....	210,343,229.84	311,481,633.76	521,824,863.60
2011.....	182,750,874.74	323,080,000.00	505,830,874.74
2012.....	165,526,391.31	305,205,000.00	470,731,391.31
2013.....	149,123,693.70	312,090,000.00	461,213,693.70
2014.....	132,482,048.48	313,225,000.00	445,707,048.48
2015.....	115,452,888.48	329,660,000.00	445,112,888.48
2016.....	97,776,049.28	308,945,000.00	406,721,049.28
2017.....	80,841,823.29	311,725,000.00	392,566,823.29
2018.....	64,312,443.47	323,930,000.00	388,242,443.47
2019.....	47,610,641.54	280,125,000.00	327,735,641.54
2020.....	32,954,883.68	247,560,000.00	280,514,883.68
2021.....	21,428,699.27	178,285,000.00	199,713,699.27
2022.....	11,956,658.73	152,615,000.00	164,571,658.73
2023.....	5,634,088.15	95,055,000.00	100,689,088.15
2024.....	1,404,390.63	15,155,000.00	16,559,390.63
2025.....	478,230.00	16,120,000.00	16,598,230.00
Total	\$ 4,116,753,077.14	\$ 6,718,974,434.01	\$ 10,835,727,511.15

(a) Includes scheduled mandatory sinking fund payments as well as serial maturities.

(b) Total represents the remaining debt service requirements from March 1, 2000 through June 30, 2000

SOURCE: State of California. Office of the Treasurer.

**STATE PUBLIC WORKS BOARD AND
OTHER LEASE-PURCHASE FINANCING
OUTSTANDING ISSUES
February 1, 2000**

<u>Name of Issue</u>	<u>Outstanding</u>
<u>GENERAL FUND SUPPORTED ISSUES:</u>	
State Public Works Board	
California Community Colleges	\$ 658,750,000
Department of Corrections *	2,600,036,141
Energy Efficiency Program (Various State Agencies) (a)	133,585,000
The Regents of The University of California * (b)	1,095,538,293
Trustees of The California State University.....	712,085,000
Various State Office Buildings.....	513,580,000
Total State Public Works Board Issues.....	\$ 5,713,574,434
Total Other State Building Lease Purchase Issues (c)	\$ 1,005,400,000
Total General Fund Supported Issues.....	\$ 6,718,974,434
<u>SPECIAL FUND SUPPORTED ISSUES:</u>	
East Bay State Building Authority Certificates of Participation	
(State of California Department of Transportation) *	\$ 84,177,399
San Bernardino Joint Powers Financing Authority	
(State of California Department of Transportation).....	60,620,000
San Francisco State Building Authority	
(State of California Department of General Services Lease) (d)	49,530,000
Total Special Fund Supported Issues.....	\$ 194,327,399
TOTAL	\$ 6,913,301,833

* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self-liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) Includes \$196,615,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

**STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
As of June 30, 1999**

<u>Issuing Agency</u>	<u>Outstanding^(a)</u>
<u>State Programs Financing:</u>	
California State University.....	\$ 449,893,000
California Transportation Commission.....	--
Department of Water Resources.....	2,504,785,000
The Regents of the University of California.....	2,817,545,000
Trade and Commerce Agency.....	--
<u>Housing Financing:</u>	
California Housing Finance Agency.....	6,054,124,133
Veterans Revenue Debenture.....	404,215,000
<u>Conduit Financing:</u>	
California Alternative Energy and Advanced Transportation Financing Authority.....	59,535,000
California Educational Facilities Authority.....	2,170,807,227
California Health Facilities Financing Authority.....	6,075,731,560
California Infrastructure and Economic Development Bank ^{(b) (c)}	387,783,908
California Passenger Rail Financing Commission.....	--
California Pollution Control Financing Authority	5,025,116,800
California School Finance Authority.....	205,000
California Student Loan Authority.....	55,260,000
California Urban Waterfront Area Restoration Financing Authority.....	3,005,000
TOTAL.....	<u>\$ 26,008,006,628</u>

^(a) Total Outstanding does not include defeased bonds and includes the accreted values for capital appreciation bonds.

^(b) Does not include \$6.0 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of three investor-owned electric utility companies representing interests in certain electric rate surcharges.

^(c) California Economic Development Financing Authority merged with California Infrastructure and Economic Development Bank effective January 1, 1999.

SOURCE: State of California, Office of the Treasurer.

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Appendix A- Exhibit 1

AUDITED GENERAL PURPOSE FINANCIAL STATEMENTS OF THE STATE OF CALIFORNIA AS OF AND FOR THE YEAR ENDED JUNE 30, 1999

Prepared under the direction of
KATHLEEN CONNELL, State Controller

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CALIFORNIA STATE AUDITOR

KURT R. SJOBERG
STATE AUDITOR

MARIANNE P. EVASHENK
CHIEF DEPUTY STATE AUDITOR

Independent Auditors' Report

THE GOVERNOR AND THE LEGISLATURE OF THE STATE OF CALIFORNIA

We have audited the accompanying general purpose financial statements of the State of California, as of and for the year ended June 30, 1999, as listed in the table of contents. These general purpose financial statements are the responsibility of the State of California's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 87 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, including those of the California State University, which reflect total assets and revenues, constituting 90 percent and 91 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 97 percent and 93 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities, is based solely upon the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the State of California, as of June 30, 1999, and the results of its operations and the cash flows of its proprietary funds and component unit authorities for the year then ended, in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The combining financial statements and schedules and required supplementary information listed in the accompanying table of contents are

BUREAU OF STATE AUDITS

555 Capitol Mall, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019

presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of California. The information for the combining financial statements and schedules and the Schedule of Funding Progress in the required supplementary information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, based upon our audit and the reports of other auditors, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole. We did not audit the required supplementary information on the Year 2000 Compliance of Computer Systems and Other Equipment and do not express an opinion on such information. In addition, we do not provide assurance that the State of California is or will become year 2000 compliant, that the State of California's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the State of California does business are or will become year 2000 compliant.

We did not audit the data included in the introductory and statistical sections of this report, and accordingly, we express no opinion on them. In accordance with *Government Auditing Standards*, reports on the State's internal control structure and on its compliance with laws and regulations will be issued in our single audit report.

BUREAU OF STATE AUDITS

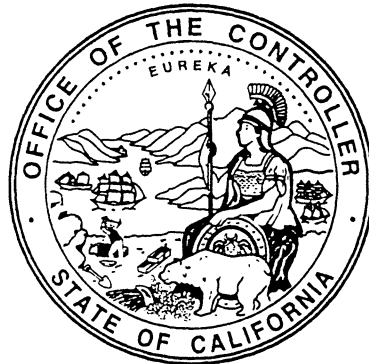

PHILIP J. JELICICH, CPA
Deputy State Auditor

November 19, 1999

STATE OF CALIFORNIA

**GENERAL PURPOSE
FINANCIAL STATEMENTS**

For the Year Ended
June 30, 1999



*Prepared by the Office of the
State Controller*

KATHLEEN CONNELL
State Controller

Combined Balance Sheet

All Fund Types, Account Groups, and
Discretely Presented Component Units

June 30, 1999

(Amounts in thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
ASSETS AND OTHER DEBITS					
Cash and pooled investments (Note 3).....	\$ 2,298,441	\$ 6,936,233	\$ 61,591	\$ 2,445,231	\$ 339,325
Investments (Note 3).....	—	9,142	8,445	4,653,100	187,876
Amount on deposit with U.S. Treasury.....	—	—	—	—	—
Receivables (net).....	177,165	434,699	292	137,843	4,315
Due from other funds (Note 4).....	5,498,027	3,508,755	146,093	259,833	315,368
Due from primary government.....	—	—	—	—	—
Due from other governments.....	412,016	4,981,312	6	75,252	10,523
Prepaid items.....	—	—	—	6,839	27,733
Food stamps (Note 1D).....	—	422,387	—	—	—
Inventories, at cost.....	—	—	—	15,647	87,887
Net investment in direct financing leases (Note 6).....	—	—	—	4,938,296	—
Advances and loans receivable.....	419,443	1,523,237	—	2,590,990	—
Deferred charges.....	—	—	—	1,066,908	—
Fixed assets (Note 7).....	—	—	—	4,885,504	514,660
Investment in UCSF Stanford Health Care.....	—	—	—	—	—
Other assets.....	918	33,633	2	21,699	11,958
Amount to be provided for retirement of long-term obligations.....	—	—	—	—	—
Total Assets and Other Debits.....	\$ 8,806,010	\$ 17,849,398	\$ 216,429	\$ 21,097,142	\$ 1,499,645

Fiduciary Fund Type	Account Groups		Total Primary Government (Memorandum Only)	Component Units		Total Reporting Entity (Memorandum Only)
	General Fixed Assets	General Long-Term Obligations		University of California	Special Purpose Authorities	
\$ 21,185,205	\$ —	\$ —	\$ 33,266,026	\$ 91,109	\$ 990,107	\$ 34,347,242
289,321,808	—	—	294,180,371	61,883,904	7,628,984	363,693,259
4,986,057	—	—	4,986,057	—	—	4,986,057
10,496,495	—	—	11,250,809	1,638,431	338,643	13,227,883
5,703,537	—	—	15,431,613	144,007	—	15,575,620
—	—	—	—	166,664	3,733	170,397
1,211,908	—	—	6,691,017	152,779	—	6,843,796
38,265	—	—	72,837	—	335	73,172
—	—	—	422,387	—	—	422,387
—	—	—	103,534	88,274	—	191,808
—	—	—	4,938,296	—	—	4,938,296
1,381,903	—	—	5,915,573	—	5,153,597	11,069,170
—	—	—	1,066,908	86,179	63,365	1,216,452
—	17,445,527	—	22,845,691	15,202,443	533,130	38,581,264
—	—	—	—	399,573	—	399,573
140,719	—	—	208,929	1,325	847,366	1,057,620
—	—	23,875,578	23,875,578	—	—	23,875,578
\$ 334,465,897	\$ 17,445,527	\$ 23,875,578	\$ 425,255,626	\$ 79,854,688	\$ 15,559,260	\$ 520,669,574

(Continued)

Combined Balance Sheet

All Fund Types, Account Groups, and
Discretely Presented Component Units

June 30, 1999

(Amounts in thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
LIABILITIES					
Accounts payable.....	\$ 1,073,458	\$ 1,438,056	\$ 15,032	\$ 131,035	\$ 161,330
Due to other funds (Note 4).....	2,073,164	4,977,245	106,406	338,422	182,676
Due to component units (Note 4).....	69,804	96,019	—	—	—
Due to other governments.....	2,451,394	1,996,831	11,162	147,413	75,248
Dividends payable.....	—	—	—	—	—
Deferred revenue (Note 1D).....	—	422,448	—	—	—
Advances from other funds.....	483,893	61,649	—	35,273	95,951
Tax overpayments.....	—	9,919	—	—	—
Benefits payable.....	—	—	—	355,788	43,127
Deposits.....	5	18,247	—	3,723	702
Contracts and notes payable.....	—	—	—	585	21,049
Lottery prizes and annuities.....	—	—	—	2,903,192	—
Compensated absences payable (Note 9).....	130,219	—	—	27,334	37,988
Certificates of participation, commercial paper, and other borrowings (Notes 10, 11).....	—	—	—	14,364	—
Capital lease obligations (Note 12).....	—	—	—	—	74,374
Advance collections.....	24,637	324,257	2,668	348,564	153,071
General obligation bonds payable (Note 14).....	—	—	—	3,716,115	—
Revenue bonds payable (Note 15).....	—	—	—	8,907,522	—
Interest payable.....	4,706	1,988	25,338	140,359	—
Securities lending obligation.....	—	—	—	—	—
Other liabilities.....	163,471	140,363	—	398,668	21,603
Total Liabilities.....	6,474,751	9,487,022	160,606	17,468,357	867,119
FUND EQUITY AND OTHER CREDITS					
Contributed capital (Notes 1K, 17B).....	—	—	—	247,657	345,183
Investment in general fixed assets (Notes 1K, 7).....	—	—	—	—	—
Retained earnings					
Reserved for regulatory requirements (Note 1K).....	—	—	—	231,348	—
Unreserved (Note 1K).....	—	—	—	3,149,780	287,343
Total Retained Earnings.....	—	—	—	3,381,128	287,343
Fund balances					
Reserved for					
Encumbrances (Note 1K).....	591,947	2,817,946	235,092	—	—
Local agencies (Notes 1K, 3).....	—	—	—	—	—
Advances and loans (Note 1K).....	419,443	1,523,237	—	—	—
Employees' pension benefits (Note 1K).....	—	—	—	—	—
Continuing appropriations (Note 1K).....	697,593	2,894,465	36,622	—	—
Other specific purposes (Note 1K).....	—	—	—	—	—
Total Reserved.....	1,708,983	7,235,648	271,714	—	—
Unreserved					
Undesignated (Deficit) (Note 1K).....	622,276	1,126,728	(215,891)	—	—
Total Fund Equity and Other Credits (Note 1K).....	2,331,259	8,362,376	55,823	3,628,785	632,526
Total Liabilities, Fund Equity, and Other Credits....	\$ 8,806,010	\$ 17,849,398	\$ 216,429	\$ 21,097,142	\$ 1,499,645

Fiduciary Fund Type	Account Groups		Total Primary Government (Memorandum Only)	Component Units		Total Reporting Entity (Memorandum Only)
	Trust and Agency	General Fixed Assets	General Long-Term Obligations	University of California	Special Purpose Authorities	
\$ 4,859,863	\$ —	\$ —	\$ 7,678,774	\$ 1,481,794	\$ 15,481	\$ 9,176,049
7,753,700	—	—	15,431,613	144,007	—	15,575,620
4,574	—	—	170,397	—	—	170,397
3,561,588	—	—	8,243,636	—	7,996	8,251,632
—	—	—	—	—	245,763	245,763
—	—	—	422,448	—	—	422,448
295,956	—	—	972,722	—	—	972,722
1,702,636	—	—	1,712,555	—	—	1,712,555
921,437	—	—	1,320,352	—	4,905,961	6,226,313
836,679	—	—	859,356	1,006,806	110,195	1,976,357
—	—	—	21,634	—	4,056	25,690
—	—	—	2,903,192	—	—	2,903,192
—	—	1,057,903	1,253,444	320,830	29,658	1,603,932
—	—	425,644	440,008	1,044,033	—	1,484,041
—	—	3,440,203	3,514,577	1,250,017	110	4,764,704
144,330	—	—	997,527	—	180,866	1,178,393
—	—	16,167,030	19,883,145	—	—	19,883,145
—	—	810,300	9,717,822	2,504,395	6,001,366	18,223,583
—	—	—	172,391	—	139,540	311,931
27,071,713	—	—	27,071,713	8,335,229	—	35,406,942
2,143,098	—	1,974,498	4,841,701	—	883,251	5,724,952
49,295,574	—	23,875,578	107,629,007	16,087,111	12,524,243	136,240,361
—	—	—	592,840	—	109	592,949
—	17,445,527	—	17,445,527	11,235,506	—	28,681,033
—	—	—	231,348	—	592,099	823,447
—	—	—	3,437,123	—	2,442,809	5,879,932
—	—	—	3,668,471	—	3,034,908	6,703,379
—	—	—	3,644,985	—	—	3,644,985
14,154,824	—	—	14,154,824	—	—	14,154,824
581,043	—	—	2,523,723	—	—	2,523,723
259,387,488	—	—	259,387,488	44,136,764	—	303,524,252
—	—	—	3,628,680	—	—	3,628,680
11,046,968	—	—	11,046,968	5,016,223	—	16,063,191
285,170,323	—	—	294,386,668	49,152,987	—	343,539,655
—	—	—	1,533,113	3,379,084	—	4,912,197
285,170,323	17,445,527	—	317,626,619	63,767,577	3,035,017	384,429,213
\$ 334,465,897	\$ 17,445,527	\$ 23,875,578	\$ 425,255,626	\$ 79,854,688	\$ 15,559,260	\$ 520,669,574

(Concluded)

The notes to the financial statements are an integral part of this statement.

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances

All Governmental Fund Types and Expendable Trust Funds

Year Ended June 30, 1999

(Amounts in thousands)

	Governmental Fund Types			Fiduciary Fund Type	Total Primary Government (Memorandum Only)
	General	Special Revenue	Capital Projects	Expendable Trust	
REVENUES					
Taxes.....	\$ 57,974,496	\$ 5,088,236	\$ —	\$ 4,212,854	\$ 67,275,586
Intergovernmental.....	4,463	29,663,519	—	658,247	30,326,229
Licenses and permits.....	57,615	3,277,248	—	—	3,334,863
Natural resources.....	9,794	6,156	—	—	15,950
Charges for services.....	112,592	699,744	—	10,124	822,460
Fees and penalties.....	86,012	1,771,086	—	520,295	2,377,393
Investment and interest.....	323,820	350,141	18,777	834,583	1,527,321
Escheat.....	—	—	—	166,186	166,186
Receipts from depositors.....	—	—	—	341,928	341,928
Other.....	93,185	292,797	21,107	572,338	979,427
Total Revenues.....	58,661,977	41,148,927	39,884	7,316,555	107,167,343
EXPENDITURES					
Current					
General government.....	1,790,940	3,465,668	80	71,115	5,327,803
Education.....	26,887,587	4,160,419	16	1,794,261	32,842,283
Health and welfare.....	15,867,239	25,330,603	—	4,611,234	45,809,076
Resources.....	939,827	1,408,541	3,428	16,302	2,368,098
State and consumer services.....	413,033	379,901	4,193	69	797,196
Business and transportation.....	475,031	6,277,698	30	21,396	6,774,155
Correctional programs.....	4,155,703	226,426	—	—	4,382,129
Property tax relief.....	599,004	—	—	—	599,004
Payments to depositors.....	—	—	—	218,753	218,753
Capital outlay.....	83,295	305,425	551,029	—	939,749
Debt service					
Principal retirement.....	1,017,939	8,777	19,834	—	1,046,550
Interest and fiscal charges.....	969,686	86,548	67,362	—	1,123,596
Total Expenditures.....	53,199,284	41,650,006	645,972	6,733,130	102,228,392
Excess (Deficiency) of Revenues Over (Under) Expenditures.....	5,462,693	(501,079)	(606,088)	583,425	4,938,951
OTHER FINANCING SOURCES (USES)					
Proceeds from general obligation bonds, commercial paper, and capital leases.....	83,295	2,799,396	1,016,079	—	3,898,770
Proceeds from refunding long-term debt.....	—	278,960	78,460	—	357,420
Operating transfers in.....	303,020	3,542,683	76,713	285,172	4,207,588
Operating transfers out.....	(1,275,529)	(2,720,960)	(16)	(224,853)	(4,221,358)
Transfers out - component unit.....	(2,789,601)	(30,840)	(2,547)	—	(2,822,988)
Payment to refunding escrow agent.....	—	(278,960)	(78,460)	—	(357,420)
Payment to refund commercial paper.....	—	(1,624,970)	(624,010)	—	(2,248,980)
Total Other Financing Sources (Uses).....	(3,678,815)	1,965,309	466,219	60,319	(1,186,968)
Excess (Deficiency) of Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses.....	1,783,878	1,464,230	(139,869)	643,744	3,751,983
Fund Balances, July 1, 1998.....	547,381	6,898,146	195,692	10,984,267	18,625,486
Fund Balances, June 30, 1999.....	<u>\$ 2,331,259</u>	<u>\$ 8,362,376</u>	<u>\$ 55,823</u>	<u>\$ 11,628,011</u>	<u>\$ 22,377,469</u>

*Restated (see Note 1L)

Combined Statement of Revenues, Expenses, and Changes in Retained Earnings

All Proprietary Fund Types and Discretely Presented Component Units –
Special Purpose Authorities

Year Ended June 30, 1999

(Amounts in thousands)

	Proprietary Fund Types		Total Primary Government (Memorandum Only)	Component Units Special Purpose Authorities	Total Reporting Entity (Memorandum Only)
	Enterprise	Internal Service			
OPERATING REVENUES					
Lottery ticket sales.....	\$ 2,498,298	\$ —	\$ 2,498,298	\$ —	\$ 2,498,298
Service and sales.....	1,175,712	2,387,158	3,562,870	128,765	3,691,635
Earned premiums (net).....	282	—	282	1,211,115	1,211,397
Investment and interest.....	252,095	—	252,095	361,063	613,158
Contributions.....	—	—	—	2,740	2,740
Rent.....	393,797	—	393,797	20,744	414,541
Other.....	24,881	8,228	33,109	108,405	141,514
Total Operating Revenues.....	4,345,065	2,395,386	6,740,451	1,832,832	8,573,283
OPERATING EXPENSES					
Lottery prizes.....	1,307,443	—	1,307,443	—	1,307,443
Personal services.....	260,034	341,604	601,638	64,914	666,552
Supplies.....	75,719	30,495	106,214	—	106,214
Services and charges.....	894,818	1,967,972	2,862,790	191,679	3,054,469
Depreciation.....	102,817	77,766	180,583	12,308	192,891
Benefit payments.....	—	—	—	1,444,727	1,444,727
Interest expense.....	527,023	3,366	530,389	360,715	891,104
Amortization of deferred charges.....	127,003	—	127,003	167,507	294,510
Total Operating Expenses.....	3,294,857	2,421,203	5,716,060	2,241,850	7,957,910
Operating Income (Loss).....	1,050,208	(25,817)	1,024,391	(409,018)	615,373
NONOPERATING REVENUES (EXPENSES)					
Grants received.....	277	—	277	70,291	70,568
Grants provided.....	(625,946)	—	(625,946)	(70,291)	(696,237)
Investment and interest income.....	121,027	14,312	135,339	670,149	805,488
Interest expense and fiscal charges.....	(209,554)	(7)	(209,561)	(3,127)	(212,688)
Dividends paid.....	—	—	—	(122,759)	(122,759)
Lottery payments for education.....	(868,084)	—	(868,084)	—	(868,084)
Other.....	(5,764)	(1,475)	(7,239)	(31,309)	(38,548)
Total Nonoperating Revenues (Expenses).....	(1,588,044)	12,830	(1,575,214)	512,954	(1,062,260)
Income (Loss) Before Operating Transfers.....	(537,836)	(12,987)	(550,823)	103,936	(446,887)
OPERATING TRANSFERS					
Operating transfers in.....	48,709	15,138	63,847	—	63,847
Operating transfers out.....	(49,827)	(250)	(50,077)	—	(50,077)
Total Operating Transfers.....	(1,118)	14,888	13,770	—	13,770
Net Income (Loss).....	(538,954)	1,901	(537,053)	103,936	(433,117)
Retained Earnings, July 1, 1998.....	3,920,082 *	285,442	4,205,524	2,930,972	7,136,496
Retained Earnings, June 30, 1999.....	\$ 3,381,128	\$ 287,343	\$ 3,668,471	\$ 3,034,908	\$ 6,703,379

*Restated (see Note 1L)

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances

Non-GAAP Budgetary Basis – Budget and Actual

All Governmental Cost Funds

Year Ended June 30, 1999

(Amounts in thousands)

	General Fund		
	Budget	Actual	Variance
REVENUES			
Major taxes and licenses			
Bank and corporation taxes.....	—	\$ 5,724,002	—
Cigarette and tobacco tax.....	—	150,190	—
Inheritance, estate and gift taxes.....	—	890,488	—
Insurance gross premiums tax.....	—	1,253,972	—
Vehicle license fees.....	—	—	—
Motor vehicle fuel tax.....	—	—	—
Personal income tax.....	—	30,891,481	—
Retail sales and use taxes.....	—	18,957,484	—
Other major taxes and licenses.....	—	331,015	—
Total Major Taxes and Licenses.....	—	58,198,632	—
Minor revenues.....	—	736,512	—
Total Revenues.....	—	58,935,144	—
EXPENDITURES			
Legislative, judicial, executive.....	\$ 2,083,916	\$ 2,054,153	\$ 29,763
State and consumer services.....	424,462	421,870	2,592
Business, transportation and housing.....	25,092	25,041	51
Trade and commerce.....	109,188	107,265	1,923
Resources.....	894,915	869,370	25,545
Environmental protection.....	146,684	144,728	1,956
Health and welfare.....	16,470,056	16,015,209	454,847
Correctional programs.....	4,314,252	4,165,251	149,001
Education.....	29,924,670	29,887,471	37,199
General government			
Tax relief and shared revenues.....	621,275	604,988	16,287
Debt service.....	2,003,814	1,987,913	15,901
Other general government.....	1,063,042	988,624	74,418
Total Expenditures.....	\$ 58,081,366	\$ 57,271,883	\$ 809,483
OTHER FINANCING SOURCES (USES)			
Transfers from other funds.....	—	93,878	—
Transfers to other funds.....	—	(996,571)	—
Other additions and deductions.....	—	339,464	—
Total Other Financing Sources (Uses).....	—	(563,229)	—
Excess of Revenues and Other Sources Over Expenditures and Other Uses.....	—	1,100,032	—
FUND BALANCES			
Fund Balances, July 1, 1998, Restated (Note 2C).....	—	2,807,639	—
Fund Balances, June 30, 1999.....	—	\$ 3,907,671	—

Other Governmental Cost Funds			Total		
Budget	Actual	Variance	Budget	Actual	Variance
—	\$ 235	—	—	\$ 5,724,237	—
—	826,323	—	—	976,513	—
—	1	—	—	890,489	—
—	—	—	—	1,253,972	—
—	3,730,813	—	—	3,730,813	—
—	3,025,226	—	—	3,025,226	—
—	3,384	—	—	30,894,865	—
—	3,933,209	—	—	22,890,693	—
—	1,882,842	—	—	2,213,857	—
—	13,402,033	—	—	71,600,665	—
—	3,894,145	—	—	4,630,657	—
—	17,296,178	—	—	76,231,322	—
\$ 492,371	\$ 469,982	\$ 22,389	\$ 2,576,287	\$ 2,524,135	\$ 52,152
485,460	407,876	77,584	909,922	829,746	80,176
5,348,016	4,574,758	773,258	5,373,108	4,599,799	773,309
24,256	23,531	725	133,444	130,796	2,648
873,002	825,953	47,049	1,767,917	1,695,323	72,594
470,228	455,332	14,896	616,912	600,060	16,852
3,656,476	3,600,920	55,556	20,126,532	19,616,129	510,403
16,852	16,223	629	4,331,104	4,181,474	149,630
756,681	734,622	22,059	30,681,351	30,622,093	59,258
3,996,421	3,996,421	—	4,617,696	4,601,409	16,287
501	263	238	2,004,315	1,988,176	16,139
169,971	123,973	45,998	1,233,013	1,112,597	120,416
\$ 16,290,235	\$ 15,229,854	\$ 1,060,381	\$ 74,371,601	\$ 72,501,737	\$ 1,869,864
—	14,514,646	—	—	14,608,524	—
—	(15,419,418)	—	—	(16,415,989)	—
—	175,277	—	—	514,741	—
—	(729,495)	—	—	(1,292,724)	—
—	1,336,829	—	—	2,436,861	—
—	4,696,668	—	—	7,504,307	—
—	\$ 6,033,497	—	—	\$ 9,941,168	—

The notes to the financial statements are an integral part of this statement.

Combined Statement of Cash Flows

All Proprietary Fund Types and Discretely Presented Component Units –
Special Purpose Authorities

Year Ended June 30, 1999
(Amounts in thousands)

	Proprietary Fund Types		Component Units
	Internal		Special Purpose
	Enterprise (1)	Service (2)	Authorities
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating income (loss).....	\$ 1,050,208	\$ (25,817)	\$ (409,018)
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATIONS			
Interest expense on operating debt.....	110	3,366	357,512
Depreciation.....	102,817	77,766	12,308
Accretion of capital appreciation bonds.....	10,871	—	8,896
Provisions and allowances.....	8,516	—	6,942
Accrual of deferred charges.....	(2,014)	—	(169,829)
Amortization of deferred credits.....	(3,747)	—	(5,471)
Amortization of discounts.....	3,975	—	6,852
Amortization of deferred charges.....	127,003	—	165,668
Purchase of program loans.....	(13)	—	(950,538)
Collection of principal from program loans.....	—	—	566,520
Other.....	13,813	(3,587)	(27,144)
Change in assets and liabilities			
Receivables.....	(18,412)	(583)	(20,125)
Due from other funds.....	(8,410)	134,314	—
Due from primary government.....	—	—	(1,169)
Due from other governments.....	(12,746)	(4,775)	—
Prepaid items.....	15,696	(10,435)	(71)
Inventories.....	(2,490)	(18,610)	—
Net investment in direct financing leases.....	129,596	—	—
Advances and loans receivable.....	17,835	—	—
Other assets.....	22,947	(2,868)	37,404
Accounts payable.....	12,423	20,379	(7,346)
Interest payable.....	(8,482)	—	—
Due to other funds.....	(48,398)	(39,167)	—
Due to other governments.....	(2,802)	5,760	(2,562)
Benefits payable.....	88,021	2,042	221,878
Deposits.....	(5,804)	(555)	60,926
Lottery prizes and annuities.....	(184,620)	—	—
Contracts and notes payable.....	(415)	(2,804)	128
Compensated absences payable.....	2,766	1,948	2,483
Capital lease obligations.....	—	(415)	110
Advance collections.....	(20,179)	(18,667)	533
Other liabilities.....	20,361	(11,707)	(26,841)
Total Adjustments.....	258,218	131,402	237,064
Net Cash Provided by (Used In) Operating Activities.....	1,308,426	105,585	(171,954)

(Continued)

Non-cash transactions are those portions of investing, financing, or capital activities that affected assets and liabilities but did not result in cash receipts or payments during the period.

(1) Enterprise funds had the following non-cash transactions:

- \$ 205 million on interest accreted on annuitized lottery prizes.
- \$ 31 million on unclaimed lottery prizes directly transferred for educational purposes.
- \$ 123 million unrealized loss on lottery investments.

(2) Internal service funds made non-cash transactions for installment purchases totaling approximately \$16 million to acquire equipment and for capital lease obligations of \$54 million to acquire buildings.

	Proprietary Fund Types		Component Units
	Enterprise	Internal Service (1)	Special Purpose Authorities
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Dividends paid.....	—	—	(81,938)
Return of advances from other funds.....	—	—	—
Advances from other funds.....	9,818	3,000	—
Proceeds from revenue bonds.....	129,160	—	1,185,357
Retirement of general obligation bonds.....	(263,530)	—	—
Retirement of revenue bonds.....	—	—	(871,907)
Interest paid on operating debt.....	—	(7)	(356,303)
Operating transfers in.....	47,744	15,138	—
Operating transfers out.....	(52,830)	(250)	—
Grants provided.....	(625,946)	—	(70,291)
Lottery payments for education.....	(897,845)	—	—
Net Cash Provided by (Used In) Noncapital Financing Activities.....	(1,653,429)	17,881	(195,082)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Unamortized water project costs.....	89,585	—	—
Acquisition of intangible assets.....	—	(3,742)	—
Acquisition of fixed assets.....	(312,260)	(96,863)	(15,551)
Proceeds from sale of fixed assets.....	139	24,568	36,698
Advances from other funds.....	250,457	—	—
Return of advances from other funds.....	(250,829)	—	—
Proceeds from notes payable and commercial paper.....	14,364	—	—
Principal paid on notes payable and commercial paper.....	(29,277)	(15,784)	—
Payment of capital lease obligations.....	—	(2,392)	—
Retirement of general obligation bonds.....	(37,220)	—	—
Proceeds from revenue bonds.....	544,252	—	—
Retirement of revenue bonds.....	(398,894)	—	(2,391)
Interest paid.....	(214,578)	(3,366)	(3,017)
Contributed capital.....	48,801	1,007	10
Grants received.....	277	—	70,291
Operating transfers in.....	2,892	—	—
Payment to refunding bond escrow agent.....	(200,996)	—	—
Net Cash Provided by (Used In) Capital and Related Financing Activities.....	(493,287)	(96,572)	86,040
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of investments.....	(279,234)	(3,579)	(270,786)
Advances and loans provided.....	(12,616)	—	—
Collection of advances and loans.....	16,225	—	—
Proceeds from maturity and sale of investments.....	453,697	—	222,280
Interest on investments.....	120,498	14,446	669,989
Net Cash Provided by (Used in) Investing Activities.....	298,570	10,867	621,483
Net Increase (Decrease) in Cash and Pooled Investments.....	(539,720)	37,761	340,487
Cash and Pooled Investments at July 1, 1998.....	2,984,951	301,564	649,620
Cash and Pooled Investments at June 30, 1999.....	\$ 2,445,231	\$ 339,325	\$ 990,107

(Concluded)

Combined Statement of Changes in Plan Net Assets

Pension Trust Funds and Discretely Presented Component Unit –
University of California

Year Ended June 30, 1999

(Amounts in thousands)

	Primary Government Pension Trust Funds	Component Unit University of California Retirement System Funds
ADDITIONS		
Contributions		
Employer.....	\$ 3,532,657	\$ 472
Plan member.....	2,969,960	422,933
Total Contributions.....	6,502,617	423,405
Investment income		
Net appreciation in fair value of investments.....	21,999,163	3,412,380
Interest, dividends, and other investment income.....	9,069,073	1,723,734
Less: Investment expense.....	(1,625,909)	(311,953)
Net Investment Income.....	29,442,327	4,824,161
Other.....	5,273	—
Total Additions.....	35,950,217	5,247,566
DEDUCTIONS		
Benefits.....	8,209,788	629,664
Refunds of contributions.....	237,294	430,560
Administrative expense.....	192,225	28,211
Total Deductions.....	8,639,307	1,088,435
Net Increase in Fund Balance Reserved for Employees' Pension Benefits.....	27,310,910	4,159,131
Fund Balance Reserved for Employees' Pension Benefits, July 1, 1998.....	232,076,578 *	39,977,633
Fund Balance Reserved for Employees' Pension Benefits, June 30, 1999.....	\$ 259,387,488	\$ 44,136,764

* Restated (see Note 1L)

Statement of Changes in Net Assets

Investment Trust Fund – Local Agency Investment

Year Ended June 30, 1999

(Amounts in thousands)

CHANGE IN NET ASSETS RESULTING FROM OPERATIONS	
Investment and interest income.....	\$ 752,759
Less: Operating expenditures and expenses.....	(1,651)
Net Increase in Net Assets Resulting From Operations.....	751,108
DISTRIBUTIONS TO PARTICIPANTS	
Distributions paid and payable.....	(751,108)
CHANGE IN NET ASSETS RESULTING FROM DEPOSITOR TRANSACTIONS	
Receipts from depositors.....	20,225,596
Less: Withdrawals by depositors.....	(17,803,299)
Net Increase in Net Assets Resulting from Depositor Transactions.....	2,422,297
Total Change in Net Assets.....	2,422,297
Net Assets Held in Trust for Pool Participants, July 1, 1998.....	11,732,527
Net Assets Held in Trust for Pool Participants, June 30, 1999.....	\$ 14,154,824

Combined Balance Sheet – Discretely Presented Component Unit – University of California

June 30, 1999

(Amounts in thousands)

	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds	Agency Funds	Retirement System Funds	Total (Memorandum Only)
ASSETS							
Cash.....	\$ 88,777	\$ —	\$ —	\$ 2,332	\$ —	\$ —	\$ 91,109
Investments.....	4,196,167	68,837	5,071,910	1,507,756	754,339	50,284,895	61,883,904
Receivables (net).....	1,008,974	279,807	1,737	15,193	—	332,720	1,638,431
Due from other funds.....	104	—	21,015	1,316	—	121,572	144,007
Due from primary government.....	166,664	—	—	—	—	—	166,664
Due from other governments.....	151,541	1,238	—	—	—	—	152,779
Inventories, at cost.....	88,274	—	—	—	—	—	88,274
Deferred charges.....	86,179	—	—	—	—	—	86,179
Fixed assets.....	—	—	—	15,202,443	—	—	15,202,443
Investment in UCSF Stanford Health Care.....	—	—	—	399,573	—	—	399,573
Other assets.....	—	—	—	1,325	—	—	1,325
Total Assets.....	\$ 5,786,680	\$ 349,882	\$ 5,094,662	\$ 17,129,938	\$ 754,339	\$ 50,739,187	\$ 79,854,688
LIABILITIES AND FUND EQUITY							
Liabilities							
Accounts payable.....	\$ 1,389,027	\$ —	\$ 5,054	\$ 27,099	\$ —	\$ 60,614	\$ 1,481,794
Due to other funds.....	122,672	2,000	—	19,335	—	—	144,007
Deposits.....	252,467	—	—	—	754,339	—	1,006,806
Compensated absences.....	320,830	—	—	—	—	—	320,830
Commercial paper and other borrowings.....	53,037	—	—	990,996	—	—	1,044,033
Capital lease obligations.....	—	—	—	1,250,017	—	—	1,250,017
Revenue bonds payable.....	—	8,810	—	2,495,585	—	—	2,504,395
Securities lending obligation.....	873,331	14,904	602,538	302,647	—	6,541,809	8,335,229
Total Liabilities.....	3,011,364	25,714	607,592	5,085,679	754,339	6,602,423	16,087,111
Fund Equity							
Investment in general fixed assets.....	—	—	—	11,235,506	—	—	11,235,506
Fund balances							
Employees' pension benefits.....	—	—	—	—	—	44,136,764	44,136,764
Reserved for other specific purposes.....	849,821	290,872	3,520,669	354,861	—	—	5,016,223
Undesignated.....	1,925,495	33,296	966,401	453,892	—	—	3,379,084
Total Fund Equity.....	2,775,316	324,168	4,487,070	12,044,259	—	44,136,764	63,767,577
Total Liabilities and Fund Equity.....	\$ 5,786,680	\$ 349,882	\$ 5,094,662	\$ 17,129,938	\$ 754,339	\$ 50,739,187	\$ 79,854,688

The notes to the financial statements are an integral part of this statement.

Combined Statement of Changes in Fund Balances – Discretely Presented Component Unit – University of California

Year Ended June 30, 1999

(Amounts in thousands)

	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds
REVENUES AND OTHER ADDITIONS				
Student tuition and fees.....	\$ 1,082,322	\$ —	\$ —	\$ 16,596
U.S. government.....	4,616,363	3,396	—	32,998
Local government.....	110,651	—	—	—
Sales and services				
Educational activities.....	897,661	—	—	—
Medical centers.....	1,928,267	—	—	—
Auxiliary enterprises.....	615,366	—	—	—
Private gifts, grants, and contracts.....	716,513	239	48,676	87,984
Investment income				
Endowment activities.....	138,373	—	7,790	—
Securities lending.....	77,236	798	—	11,749
Other.....	184,574	9,320	—	60,345
Net appreciation (depreciation) in fair value of investments.....	(20,856)	(466)	496,303	(10,634)
Expended for plant facilities (including \$385,797 of current funds).....	—	—	—	878,000
Retirement of indebtedness.....	—	—	—	140,986
Other revenues.....	292,515	—	—	—
Transfers in — primary government.....	2,721,381	—	—	101,607
Other additions.....	49,276	8,681	1,324	27,470
Total Revenues and Other Additions.....	13,409,642	21,968	554,093	1,347,101
EXPENDITURES AND OTHER DEDUCTIONS				
Current fund expenditures				
Educational and general.....	7,028,269	—	—	—
Medical centers.....	1,858,055	—	—	—
Auxiliary enterprises.....	495,714	—	—	—
Department of Energy laboratories.....	2,997,073	—	—	—
Securities lending fees and rebates.....	73,525	760	—	11,184
Plant fund expenditures (including noncapitalized expenditures of \$25,409).....	—	—	—	517,612
Debt service				
Principal retirement.....	—	—	—	140,986
Interest.....	—	—	—	219,567
Disposal of plant assets.....	—	—	—	265,283
Debt extinguishment.....	—	—	—	(685)
Other.....	45,095	7,407	1,105	—
Total Expenditures and Other Deductions.....	12,497,731	8,167	1,105	1,153,947
TRANSFERS AMONG FUNDS				
Mandatory contractual arrangements				
Loan funds matching grants.....	(962)	962	—	—
Principal and interest.....	(286,459)	—	—	286,459
Nonmandatory (discretionary allocations).....	(310,085)	(683)	45,851	264,917
Total Transfers Among Funds.....	(597,506)	279	45,851	551,376
Change in Capitalization Threshold (Note 1H).....	—	—	—	(272,912)
Net Increase in Fund Balances.....	314,405	14,080	598,839	471,618
Fund Balances, July 1, 1998.....	2,460,911	310,088	3,888,231	11,572,641
Fund Balances, June 30, 1999.....	<u>\$ 2,775,316</u>	<u>\$ 324,168</u>	<u>\$ 4,487,070</u>	<u>\$ 12,044,259</u>

Combined Statement of Current Funds Revenues, Expenditures, and Other Changes – Discretely Presented Component Unit – University of California

Year Ended June 30, 1999

(Amounts in thousands)

	Current Funds		Total
	Unrestricted	Restricted	(Memorandum Only)
REVENUES			
Student tuition and fees.....	\$ 1,082,322	\$ —	\$ 1,082,322
U.S. government appropriations, grants and contracts.....	301,877	1,266,978	1,568,855
Local government grants and contracts.....	1,674	98,382	100,056
Sales and services			
Education activities.....	897,661	—	897,661
Medical centers.....	1,928,267	—	1,928,267
Auxiliary enterprises.....	615,366	—	615,366
Private gifts, grants and contracts.....	70,404	580,478	650,882
Investment income			
Endowment and similar funds.....	30,401	75,933	106,334
Securities lending.....	40,739	34,743	75,482
Other.....	145,654	—	145,654
Net appreciation (depreciation) in fair value of investments.....	(15,904)	—	(15,904)
Department of Energy laboratories.....	28,750	2,997,073	3,025,823
Other revenues.....	292,515	—	292,515
Transfers in — primary government.....	2,327,298	273,816	2,601,114
Total Revenues.....	7,747,024	5,327,403	13,074,427
EXPENDITURES AND MANDATORY TRANSFERS			
Educational and general			
Instructional.....	2,115,979	144,209	2,260,188
Research.....	291,029	1,573,872	1,864,901
Public service.....	132,506	106,922	239,428
Academic support.....	949,002	122,795	1,071,797
Student services.....	272,441	10,912	283,353
Institutional support.....	501,121	35,212	536,333
Operation and maintenance of plant.....	303,203	2,213	305,416
Student financial aid.....	179,946	286,907	466,853
Mandatory transfers			
Loan fund matching grant.....	723	239	962
Debt service.....	98,339	106,157	204,496
Total Educational and General Expenditures, and Mandatory Transfers.....	4,844,289	2,389,438	7,233,727
Medical centers			
Expenditures.....	1,852,961	5,094	1,858,055
Mandatory transfers.....	32,477	—	32,477
Total Medical Centers.....	1,885,438	5,094	1,890,532
Auxiliary enterprises			
Expenditures.....	488,263	7,451	495,714
Mandatory transfers.....	49,486	—	49,486
Total Auxiliary Enterprises.....	537,749	7,451	545,200
Department of Energy laboratories.....	—	2,997,073	2,997,073
Securities lending fees and rebates.....	38,782	34,743	73,525
Total Expenditures and Mandatory Transfers.....	7,306,258	5,433,799	12,740,057
OTHER TRANSFERS AND ADDITIONS (DEDUCTIONS)			
Restricted receipts in excess of restricted expenditures.....	—	285,939	285,939
Nonmandatory transfers.....	(247,129)	(62,956)	(310,085)
Other.....	10,125	(5,944)	4,181
Total Other Transfers and Additions (Deductions).....	(237,004)	217,039	(19,965)
Net Increase in Fund Balances.....	\$ 203,762	\$ 110,643	\$ 314,405

The notes to the financial statements are an integral part of this statement.

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Notes to the Financial Statements

NOTE 1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with generally accepted accounting principles (GAAP). The provisions of Governmental Accounting Standards Board (GASB) Technical Bulletin No. 99-1, Disclosures about Year 2000 Issues, an amendment of Technical Bulletin 98-1, have been implemented in this report. The provisions of GASB Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans, have been implemented in this report for the deferred compensation program for primary government employees.

A. Reporting Entity

As required by GASB Statement No. 14, The Financial Reporting Entity, these financial statements present the primary government of the State and its component units. The **primary government** consists of all funds, account groups, organizations, institutions, agencies, departments, and offices that are not legally separate from the State. GASB Statement No. 14 does not modify the fiduciary fund reporting requirements of the primary government. As a result, funds such as the Public Employees' Retirement Fund and the State Teachers' Retirement Fund are reported in the appropriate fiduciary funds. Component units are organizations that are legally separate from the State but for which the State is financially accountable, or for which the nature and significance of their relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The decision to include a potential component unit in the State's reporting entity is based on several criteria including legal standing, fiscal dependency, and financial accountability. Following is information on blended and discretely presented component units for the State.

Blended component units, although legally separate entities, are in substance part of the primary government's operations. Therefore, data from these blended component units are integrated into the appropriate funds for reporting purposes.

Building authorities are blended component units because they have been created through the use of Joint Exercise of Powers Agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects

funds. As a result, the \$784 million of capital lease arrangements between the building authorities and the State have been eliminated from the combined balance sheet. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the appropriate account groups. Copies of the financial statements of the building authorities may be obtained from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5876.

Discretely presented component units are reported in separate columns in the combined financial statements. Discretely presented component units are legally separate from the primary government, and mostly provide services to entities and individuals outside the State. For ease of presentation, discretely presented component units, other than the University of California, are included in the statements under the heading of special purpose authorities.

The University of California was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the State appoints a voting majority of the Regents of the University of California, and expenditures for the support of various University of California programs and capital outlay are appropriated by the annual Budget Act.

Copies of the University of California's separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

Special purpose authorities are presented in three separate categories for condensed financial statement reporting purposes: State Compensation Insurance Fund (SCIF), California Housing Finance Agency (CHFA), and Non-Major Component Units. SCIF and CHFA are considered major component units while all other special purpose authority component units are shown as Non-Major Component Units.

The SCIF is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, or other public corporations. It is a component unit of the State because the State appoints all five voting members of the SCIF's governing board and has the authority to approve or modify the SCIF's budget. Copies of the SCIF's financial statements for the year ended December 31, 1998, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

The CHFA was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. The CHFA's purpose is to meet

the housing needs of persons and families of low and moderate income. It is a component unit of the State because the State appoints a voting majority of the CHFA's governing board and has the authority to approve or modify its budget. Copies of the CHFA's financial statements may be obtained from the California Housing Finance Agency, 1121 L Street, Sacramento, California 95814.

State legislation created various other Non-Major Component Units to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. These entities are considered component units because the majority of governing board members are appointed by, or are members of, the primary government. Copies of the financial statements of these component units may be obtained from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5876. The Non-Major Component Units are:

The California Alternative Energy and Advanced Transportation Financing Authority, which provides financing for alternative energy and advanced transportation technologies;

The California Infrastructure and Economic Development Bank, which provides financing for business development and public improvements (Effective January 1, 1999, the *California Economic Development Financing Authority* merged with the *California Infrastructure and Economic Development Bank*.);

The California Pollution Control Financing Authority, which provides financing for pollution control facilities;

The California Health Facilities Financing Authority, which provides financing for the construction, equipping, or acquiring of health facilities;

The California Educational Facilities Authority, which issues revenue bonds to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities;

The California School Finance Authority, which provides loans to school and community college districts to assist in obtaining equipment and facilities;

The District Agricultural Associations, which exhibit all of the industries, industrial enterprises, resources, and products of the state;

The San Joaquin River Conservancy, which was created to acquire and manage public lands within the San Joaquin River Parkway; and

The California Urban Waterfront Area Restoration Financing Authority, which provides financing for coastal and inland urban waterfront restoration projects.

A joint venture is an entity, resulting from a contractual arrangement, that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. In such an arrangement, the participants retain an ongoing financial interest or an ongoing financial responsibility in the entity. These entities are not part of the primary government or a component unit.

The State participates in a joint venture with the Capitol Area Development Authority (CADA). The CADA was created in 1978 by the Joint Exercise of Powers Agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. The CADA is a public entity, separate from the primary government and the City, and is administered by a board of five members: two appointed by the primary government, two appointed by the City, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in the CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence the CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes the CADA's operations by leasing land to the CADA without consideration; however, the primary government is not obligated to do so. Since the primary government does not have an equity interest in the CADA, the CADA's financial information is not included in the financial statements of this report. Separately issued financial statements can be obtained from the Capitol Area Development Authority, 1530 Capitol Avenue, Sacramento, California 95814.

Effective November 1, 1997, the University of California, San Francisco (UCSF) Medical Center (a portion of a discretely presented component unit) and Stanford Health Services, which manages and operates Stanford University's medical center, merged through the formation of UCSF Stanford Health Care, a separate non-profit corporation (the Corporation). The Corporation is governed by a seventeen member Board of Directors consisting of representatives from both universities, selected officers of the new corporation, and three independent directors. The primary purpose of the Corporation is to support, benefit, and further the charitable, scientific, and educational purposes of the Schools of Medicine at UCSF and Stanford. The UC's investment in the Corporation is accounted for as a joint venture using the equity method of accounting. The UC's interest in the earnings of the Corporation is recorded as revenue within the current unrestricted fund and as an increase in the UC's assets. Equity distributions are recorded as a reduction in the UC's assets.

Substantially all of the medical center and clinical practice assets and liabilities of both the UCSF Medical Center and Stanford Health Services were either contributed or leased to the Corporation. The

UC leased real property to the Corporation under long-term leases for a nominal annual rent and all personal property for terms ranging from 5 to 20 years, with bargain purchase options available at the end of the lease term. Such amounts have been accounted for as part of the investment in the Corporation.

Under the terms of the agreement, the Corporation's income or losses are allocated equally between the UC and Stanford University. The agreement provides for the Corporation's Board of Directors to annually determine whether to distribute a portion of operating income as academic contributions to each university. During the year ended June 30, 1999, the UC's share of the Corporation's loss was \$17 million and the Corporation distributed \$1 million to the UC.

The UC also entered into certain operating agreements with the Corporation, primarily for the use of UC employees, facilities, and technical expertise. The UC recorded revenue of \$261 million under these agreements during the fiscal year ended June 30, 1999. In addition to the operating agreements, the UC may manage a portion of the investments of the Corporation. The fair value of these investments totaled \$199 million at June 30, 1999.

Information on the finances of the Corporation may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

The **Bay Area Toll Authority**, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer the base \$1 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. Additional information on the Bay Area Toll Authority may be obtained from the Metropolitan Transportation Commission, 101 Eighth Street, Oakland, California 94607.

B. Fund Accounting

The financial statements of the State are organized and operated on the basis of funds, account groups, and component units. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. Account groups are a reporting device to account for certain assets and liabilities of the governmental funds that are not recorded directly in those funds. A component unit is an organization which is legally separate from the State but for which the State is financially accountable, or for which the nature and significance of their relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete.

The financial activities of the State accounted for in the accompanying financial statements are classified as follows.

Governmental Fund Types are used primarily to account for services provided to the general public without charging directly for those services. The State has three governmental fund types.

The *General Fund* is the main operating fund of the State. It accounts for transactions related to resources obtained and used for those services that do not need to be accounted for in another fund.

Special Revenue Funds account for transactions related to resources obtained from specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditures for specified purposes.

Capital Projects Funds account for transactions related to resources obtained and used to acquire or construct major capital facilities.

Proprietary Fund Types present financial data on activities that are similar to those found in the private sector. Users are charged for the goods or services provided. For its proprietary funds, the State applies all applicable GASB pronouncements, pursuant to GASB Statement No. 20, as well as all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, unless the FASB Statements and Interpretations conflict with or contradict GASB pronouncements. However, with one exception, the State has elected not to apply FASB Statements and Interpretations issued after November 30, 1989. The exception is Prison Industries, an internal service fund, which has elected to follow FASB pronouncements issued after November 30, 1989, unless they conflict with or contradict GASB pronouncements. The State has two proprietary fund types.

Enterprise Funds account for goods or services provided to the general public on a continuing basis when (1) the State intends that all or most of the cost involved is to be financed by user charges, or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes.

Internal Service Funds account for goods or services provided to other agencies, departments, or governments on a cost-reimbursement basis.

Fiduciary Fund Types are used to account for assets held by the State. The State acts as a trustee or as an agent for individuals, private organizations, other governments, or other funds. The State has four fiduciary fund types.

Expendable Trust Funds account for assets held in a trustee capacity when principal, income, and earnings on principal may be expended in the course of a fund's designated operations.

Pension Trust Funds account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems.

Agency Funds account for assets held by the State, which acts as an agent for individuals, private organizations, other governments, or other funds. They are custodial in nature and do not measure the results of operations.

The *Investment Trust Fund* accounts for the deposits, withdrawals, and earnings of the Local Agency Investment Fund, an external investment pool for local governments and public agencies.

Account Groups are used to establish control over and accountability for the government's general fixed assets and general long-term obligations. The State has two account groups.

The *General Fixed Assets Account Group* accounts for governmental fixed assets not reported in a proprietary fund or a trust fund.

The *General Long-Term Obligations Account Group* accounts for unmatured general obligation bonds and other long-term obligations generally expected to be financed from governmental funds.

Discretely Presented Component Units are reported in separate columns in the combined financial statements to emphasize that they are legally separate from the primary government. The discretely presented component units are classified as the University of California and as special purpose authorities. The University of California's financial statements are prepared in conformity with GAAP using the American Institute of Certified Public Accountants College Guide Model. As a result, the University of California's activities are accounted for in the following funds: Current Funds; Loan Funds; Endowment and Similar Funds; Plant Funds; Agency Funds; and Retirement System Funds. Special purpose authorities account for their activities as enterprise funds.

C. Measurement Focus and Basis of Accounting

Governmental Fund Types and **Expendable Trust Funds** are presented using the flow of current financial resources measurement focus. With this measurement focus, operating statements present increases and decreases in net current assets; the unreserved fund balance is a measure of available spendable resources.

The accounts of the governmental fund types and expendable trust funds are reported using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded as they become measurable and available, and expenditures are recorded at the time the liabilities are incurred. Principal tax revenues

susceptible to accrual are recorded as taxpayers earn income (personal income and bank and corporation taxes), as sales are made (consumption and use taxes), and as the taxable event occurs (miscellaneous taxes), net of estimated tax overpayments. Other revenue sources are recorded when they are earned or when they are due, provided they are measurable and available within the ensuing 12 months.

Compensated absences are accounted for on a modified accrual basis of accounting. Except for expenditures in the General Fund for earned leave of academic-year faculty, compensated absences expenditures are not accrued since it is not anticipated that compensated absences will be used in excess of a normal year's accumulation.

Agency Funds are custodial in nature and do not measure the results of operations. Assets and liabilities are recorded using the modified accrual basis of accounting.

Proprietary Fund Types, the Investment Trust Fund, and Pension Trust Funds are accounted for on the flow of economic resources measurement focus.

The accounts of the proprietary fund types, the investment trust fund, and pension trust funds are reported using the accrual basis of accounting. Under the accrual basis, revenues are recognized when they are earned, and expenses are recognized when they are incurred.

Lottery revenue and the related prize expense are recognized when sales are made. Certain prizes are payable in deferred installments. Such liabilities are recorded at the present value of amounts payable in the future.

For purposes of the statement of cash flows, all cash and pooled investments in the State Treasurer's pooled investment program are considered to be cash and cash equivalents.

Discretely Presented Component Units, which are classified as the University of California and special purpose authorities, are accounted for on the flow of current resources and flow of economic resources measurement focus, respectively. All use the full accrual basis of accounting.

D. Food Stamps

The distribution of food stamp benefits is recognized as revenue and expenditures in a special revenue fund, as required by GAAP. Revenue and expenditures are recognized when the benefits are distributed to the recipients. Food stamp balances held by the counties are reported as an asset and offset by deferred revenue. Revenues, expenditures, and balances of food stamp benefits are measured based on face value.

E. Inventories

Inventories are primarily stated at either the lower of average cost or market, or at cost utilizing the weighted average valuation method. In governmental fund types, inventories are recorded as expenditures when purchased. In proprietary fund types, inventories are expensed when consumed.

The discretely presented component units have inventory policies similar to the primary government's.

F. Net Investment in Direct Financing Leases

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. The payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board to finance the construction of facilities and energy efficiency projects. Upon expiration of these leases, jurisdiction of the facilities and projects will be with the primary government agency, University of California, or local agency. The State Public Works Board records the net investment in direct financing leases at the net present value of the minimum lease payments.

G. Deferred Charges

The deferred charges account in the enterprise fund type primarily represents operating and maintenance costs and unrecovered capital costs that will be recognized as expenses over the remaining life of long-term state water supply contracts. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts.

H. Fixed Assets

The **General Fixed Assets Account Group** includes capital assets that are not assets of any specific fund, but rather of the primary government as a whole. Most of these assets arise from the expenditure of the financial resources of governmental funds and expendable trust funds used to acquire or construct them. The General Fixed Assets Account Group does not include fixed assets of proprietary funds or pension trust funds. These fixed assets are accounted for in their respective funds.

The General Fixed Assets Account Group is presented in the financial statements at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. Interest during construction has not been capitalized. Also, public domain or "infrastructure" fixed assets are not capitalized. Accumulated depreciation is not recorded in the General Fixed Assets Account Group. Purchased fixed assets are stated at historical cost. Tangible and intangible property are capitalized if the property has a normal useful life of at least one year and an acquisition cost of at least \$5,000.

Proprietary Fund Type fixed assets, consisting of property, plant, and equipment, are stated at cost at the date of acquisition, less accumulated depreciation. They are depreciated over their estimated useful or service lives, ranging from two to 100 years, using the straight-line method of depreciation. Dormitory facilities, which represent 16.2% of the fixed assets of the enterprise funds, are not depreciated.

The fixed assets of the **discretely presented component units** are stated at cost at the date of acquisition, or fair market value at the date of donation in the case of gifts. Depreciation on the majority of the fixed assets of the discretely presented component units is not recorded, which is consistent with GAAP. On July 1, 1998, the University of California increased the threshold for capitalizing fixed assets from \$500 to \$1,500. Therefore, \$273 million of fixed assets with a value of less than \$1,500 were written off and are included as a separate line item on the Combined Statement of Changes in Fund Balances.

I. Long-Term Obligations

The primary government reports long-term obligations of governmental funds in the General Long-Term Obligations Account Group. Long-term obligations consist of certain unmatured general obligation bonds, certain unmatured revenue bonds, capital lease obligations, certificates of participation, commercial paper, the net pension obligation of the pension trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, and the primary government's share of the University of California pension liability.

With approval in advance from the Legislature, certain authorities and state agencies may issue revenue bonds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds, the building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of the building authorities, which are included in capital projects funds, the liability for revenue bonds is recorded in the respective fund.

J. Compensated Absences

In the governmental funds, only the amounts of compensated absences that normally would be liquidated with expendable available financial resources are accrued at year end, such as costs of academic-year faculty. The costs of the academic-year faculty represent services rendered over a ten-month period that are paid over a 12-month period. The balance of the amounts owed for services rendered is reported as a current liability in the General Fund. Unless it is anticipated that compensated absences will be used in excess of a normal year's accumulation, no additional liabilities are accrued. As a result, the unpaid liability for governmental funds is recorded in the General Long-Term Obligations Account Group. Accumulated sick-leave balances are not included in the compensated absences because they do not vest to employees. However, unused sick-leave balances convert to service credits upon retirement.

The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued when incurred in proprietary funds. In the discretely presented component units, the compensated absences are accounted for in a similar manner as the proprietary funds in the primary government.

K. Fund Equity

Fund equity accounts present the difference between assets and liabilities of a fund. The fund equity accounts consist of *contributed capital* and *retained earnings* for proprietary funds and certain component units, *investment in general fixed assets* for the General Fixed Assets Account Group and certain component units, and *fund balance* for governmental funds, trust funds, and certain component units.

Contributed capital is the permanent fund capital of a proprietary fund. Contributed capital is created when a residual equity transfer is received by a proprietary fund, when a general fixed asset is "transferred" to a proprietary fund, or when a grant is received that is externally restricted to capital acquisition or construction.

Retained earnings are divided into two sections: *reserved for regulatory requirements* and *unreserved*. The reserved for regulatory requirements represents a segregation of the retained earnings in enterprise funds and certain component units for amounts that are unavailable for general use as a result of specific legal requirements. Unreserved retained earnings represent the accumulated earnings of proprietary funds and certain component units that are not reserved for any specific purpose.

The fund balances for governmental funds and trust funds are divided into two sections: *reserved* and *unreserved-undesignated*. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balances that are legally segregated for specific uses. The reserves of the fund balance for governmental funds, trust funds, and component units are as follows:

Reserved for encumbrances represents goods and services that are ordered, but not received, by the end of the year.

Reserved for local agencies represents amounts held on behalf of local governments and local public agencies in the Local Agency Investment Fund, an investment trust fund.

Reserved for advances and loans receivable represents advances to other funds and the non-current portion of loans receivable that do not represent expendable available financial resources.

Reserved for employees' pension benefits represents reserves of the pension trust funds and the University of California, a discretely presented component unit. These reserves include accumulated contributions made by employees and employers, and undistributed interest and investment earnings.

Reserved for continuing appropriations represents the unencumbered balance of all appropriations for which the period of availability extends beyond the period covered by this report. These appropriations are legally segregated for a specific future use.

Reserved for other specific purposes includes trust and agency fund amounts of the Unemployment Fund, Deferred Compensation Plan Fund, other expendable trust funds, and the University of California, a discretely presented component unit, that are not available for future appropriations other than those for which the funds were established.

The *unreserved-undesignated* amounts represent the net of total fund balance, less reserves, for governmental funds and certain component units.

Investment in general fixed assets represents the fixed assets of the governmental funds and expendable trust funds reported in the General Fixed Assets Account Group and the fixed assets of the University of California, a discretely presented component unit, that are restricted for specific purposes.

**L. Restatement of
Beginning Fund
Equity**

The beginning fund balance of the special revenue funds has been increased by \$54 million as a result of the changing relationship between the trial courts and the State. As a result of Chapter 850 of the Statutes of 1997, the financial information of the trial courts is required to be included in the CAFR.

The beginning fund balance of the capital projects funds has been increased by \$7 million as a result of reclassifying the San Bernardino State Building Authority Fund from an agency fund to a capital projects fund.

The beginning retained earnings in the enterprise funds has been increased by \$141 million as a result of errors made in the prior year financial statements and the recognition of long-term notes receivable and correction of recorded liabilities.

The beginning fund balance of the expendable trust funds has been increased by \$4.0 billion as a result of GASB Statement No. 32, which reclassified the Deferred Compensation Program (IRC 457) for the primary government from an agency fund to an expendable trust fund, and as a result of the Volunteer Firefighters' Length of Service Award Fund being reclassified from an expendable trust fund to a pension trust fund.

The beginning net assets of the pension trust funds have been increased by \$2 million as a result of reclassifying the Volunteer Firefighters' Length of Service Award Fund from an expendable trust fund to a pension trust fund.

- M. Guaranty Deposits** The State is custodian of guaranty deposits held to protect consumers, to secure the State's deposits in financial institutions, and to ensure payment of taxes and fulfillment of obligations to the State. Guaranty deposits of securities and other properties are not shown on the financial statements.
- N. Memorandum Only
Total Columns** Total columns captioned "memorandum only" do not represent consolidated financial information and are presented only to facilitate financial analysis. The columns do not present information that reflects financial position, results of operations, or cash flows in accordance with generally accepted accounting principles. Interfund eliminations have not been made in the aggregation of this data.

NOTE 2.**BUDGETARY AND LEGAL COMPLIANCE**

- A. Budgeting and
Budgetary Control** The State's annual budget is prepared primarily on a modified accrual basis for governmental funds. The Governor recommends a budget for approval by the Legislature each year. This recommended budget includes estimated revenues; however, revenues are not included in the budget adopted by the Legislature. Under state law, the State cannot adopt a spending plan that exceeds estimated revenues.

Under the State Constitution, money may be drawn from the treasury only through a legal appropriation. The appropriations contained in the Budget Act, as approved by the Legislature and signed by the Governor, are the primary sources of annual expenditure authorizations and establish the legal level of control at the appropriation level for the annual operating budget. The budget can be amended throughout the year by special legislative action, budget revisions by the Department of Finance, or executive orders by the Governor.

Amendments to the initial budget for the year ended June 30 were legally made, and are included in the budget data in the financial statements. The amendments had the effect of increasing spending authority and expenditures for the year.

Appropriations are generally available for expenditure or encumbrance either in the year appropriated or for a period of three years if the legislation does not specify a period of availability. At the end of the availability period, the encumbering authority for the unencumbered balance lapses. Some appropriations continue indefinitely while others are available until fully spent. Generally, encumbrances must be liquidated within two years from the end of the period when the appropriation is available. If the encumbrances are not liquidated within this additional two-year period, the spending authority for these encumbrances lapses.

Legislative appropriations are based on when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year goods and services are received. The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances Non-GAAP Budgetary Basis – Budget and Actual includes all the current year expenditures for governmental cost funds and their related appropriations that are legislatively authorized annually, continually, or by project.

B. Legal Compliance

State agencies are responsible for exercising basic budgetary control and ensuring that appropriations are not overspent. The State Controller's Office is responsible for overall appropriation control and does not allow expenditures in excess of authorized appropriations.

Financial activities are mainly controlled at the appropriation level but can vary depending on the presentation and wording contained in the Budget Act. Certain items that are established at the category, program, component, or element levels can be adjusted by the Department of Finance. While the financial activities are controlled at various levels, the legal level of budgetary control has been established in the Budget Act at the appropriation level for the annual operating budget.

The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, Non-GAAP Budgetary Basis – Budget and Actual is not presented in this document at the legal level of budgetary control, as such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's Codification of Governmental Accounting and Financial Reporting Standards Section 2400.112. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5876.

**C. Reconciliation of
Budgetary Basis with
GAAP Basis**

The State annually reports its financial condition based on GAAP (GAAP basis) and on the State's budgetary provisions (budgetary basis). The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances Non-GAAP Budgetary Basis – Budget and Actual is compiled on the budgetary basis. The differences between budgetary basis fund balances and the fund equity prepared in accordance with GAAP are explained and reconciled in the following paragraphs and Table 1.

The beginning fund balance on the budgetary basis is restated for "prior year revenue adjustments" and "prior year expenditure adjustments." A prior year revenue adjustment occurs when the actual amount received in the current year differs from the prior year accrual of revenues. A prior year expenditure adjustment results when the actual amount paid in the current year differs from the prior year accrual for appropriations whose ability to encumber funds has lapsed in previous periods. The beginning fund balance on a GAAP basis is not affected by this adjustment.

Perspective Difference

Fund classification: On a budgetary basis, the State's funds are classified as either governmental cost funds or nongovernmental cost funds. The governmental cost funds consist of the General Fund and other governmental cost funds into which revenues from taxes, licenses, and fees that support the general operations of the State are deposited. The nongovernmental cost funds are not subject to annual appropriated budgets and consist of funds into which monies derived from sources other than general and special taxes, licenses, fees, or other state revenues are deposited. On a GAAP basis, the financial information is classified as governmental, proprietary, or fiduciary funds, or as component units.

Basis Difference

Advances and loans receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The General Fund had education loans outstanding as of June 30, 1999, of \$635 million, which will be forgiven and charged to expenditures in the year of appropriation on a budgetary basis. On a GAAP basis, these education loans were charged to expenditures for the year ended June 30, 1996, the year that the agreement was made to forgive the loans. The adjustments related to advances and loans caused a decrease to the fund balance of \$590 million in the General Fund and an increase to the fund balance of \$1.5 billion in special revenue funds, \$363 million in enterprise funds, and \$581 million in trust and agency funds.

Escheat property: A liability for the estimated amount of escheat property ultimately expected to be reclaimed and paid is not reported on a budgetary basis, while it is required to be reported on a GAAP basis. This adjustment caused a \$484 million decrease to the General Fund balance.

Authorized and unissued bonds: General obligation bonds that are not self-liquidating are recorded as additions to the fund balance for the special revenue and capital projects funds on the budgetary basis when voters authorize the sale of bonds. However, in accordance with GAAP, only the bonds issued during the year are recorded as additions to the fund balance. The adjustments related to authorized and unissued bonds caused a decrease to fund balance of \$10.9 billion in special revenue funds and \$723 million in capital projects funds.

Provision for long-term obligations: On the budgetary basis, a provision for long-term obligations is used to offset certain bonds payable. However, in accordance with GAAP, this account is not used for enterprise funds. This adjustment caused a \$2.8 billion decrease to the enterprise fund balance.

Encumbrances: The State does not record certain encumbrances on a budgetary basis that are recorded on a GAAP basis. The adjustments related to encumbrances caused an increase to the fund balance of \$516 million in special revenue funds.

Fixed assets: For certain enterprise programs, the budgetary basis uses the modified accrual basis of accounting for fixed assets, which expenses fixed asset costs. In accordance with GAAP, fixed assets for enterprise funds should be capitalized and depreciated using the accrual basis of accounting. This adjustment caused a \$1.4 billion increase to the enterprise fund balance.

Fair value of investments: The increase in Lottery Fund investments for adjustments to fair value does not result in a corresponding increase in a liability on the budgetary basis. However, on a GAAP basis, the liability is increased since the investments will be used for lottery prizes and annuities. This adjustment caused a \$203 million decrease to the enterprise fund balance.

Fund balances in agency funds: Fund balances are reported in agency funds on the budgetary basis. In accordance with GAAP, agency funds do not have a fund balance since they account for assets held solely in a custodial capacity. Accordingly, assets in agency funds are always matched with liabilities to the owners of these assets. This adjustment caused a \$21.5 billion decrease to the agency fund balance.

California accounting practices for insurance: The financial statements of the State Compensation Insurance Fund (SCIF) on a budgetary basis are prepared in conformity with accounting practices prescribed by the Department of Insurance of the State of California. The principal differences between this method and GAAP are that investments are carried at amortized cost rather than fair value and policy acquisition costs are charged to current operations rather than being deferred. This adjustment caused a \$374 million increase to the discretely presented component units fund balance.

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused an increase in fund balance of \$135 million in special revenue funds, \$17 million in trust and agency funds, and \$1 million in component units and a decrease in fund balance of \$155 million in the General Fund, \$35 million in capital projects funds, \$50 million in enterprise funds, and \$3 million in internal service funds.

Timing Difference

Liabilities budgeted in subsequent years: The primary government does not, on a budgetary basis, accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused a net decrease to the fund balance of \$347 million in the General Fund and \$120 million in special revenue funds.

Entity Difference

Entities not included in the State's accounting system: There are some discretely presented component units that are not included in the budgetary basis accounting system, but are included on a GAAP basis. This adjustment caused a \$64.1 billion increase to the component units fund balance, of which \$63.8 billion is related to the University of California.

Table 1

Reconciliation of Budgetary Basis Fund Balances and GAAP Basis Fund Equity

June 30, 1999

(Amounts in thousands)

	Total Budgetary Fund Classifications	Primary Government					Component Units
		Governmental Fund Types		Proprietary Fund Types		Fiduciary Fund Types	
		General	Special Revenue	Capital Projects	Enterprise	Internal Service	Trust and Agency
Perspective Difference							
Budgetary / Legal Basis Annual Report							
General Fund.....	\$ 3,907,671	\$ 3,907,671	\$ —	\$ —	\$ —	\$ —	\$ —
Other Governmental Cost Funds.....	6,033,497	—	5,858,359	37,764	1,299	14,922	121,153
Non-Governmental Cost Funds.....	325,986,701	—	11,357,345	776,587	4,913,624	620,184	305,967,217
Total Budgetary Fund Balances							
Reclassified into GAAP Statement							
Fund Structure.....	\$ 335,927,869	3,907,671	17,215,704	814,351	4,914,923	635,106	306,088,370
Basis Difference							
Advances and loans receivable.....		(590,248)	1,523,237	—	362,501	—	581,043
Escheat property.....		(483,893)	—	—	—	—	—
Authorized and unissued bonds.....		—	(10,907,292)	(723,332)	—	—	—
Provision for long-term obligations.....		—	—	—	(2,802,828)	—	—
Encumbrances.....		—	515,592	—	—	—	—
Fixed assets.....		—	—	—	1,407,289	—	—
Fair value of investments.....		—	—	—	(203,336)	—	—
Fund balances in agency funds.....		—	—	—	—	—	—
California accounting practices for insurance.....		—	—	—	—	—	(21,516,392)
Other.....		(154,805)	134,938	(35,196)	(49,764)	(2,580)	374,044
Timing Difference							
Liabilities budgeted in subsequent years.....		(347,466)	(119,803)	—	—	—	1,310
Entity Difference							
Entities not included in State's accounting system.....		—	—	—	—	—	—
GAAP Fund Equity, June 30, 1999.....	\$ 2,331,259	\$ 8,362,376	\$ 55,823	\$ 3,628,785	\$ 632,526	\$ 285,170,323	\$ 66,802,594
							64,075,496

NOTE 3.**DEPOSITS AND INVESTMENTS**

As required by GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools, the State reports investments at fair value.

State statutes authorize investments in certain types of securities. The State Treasurer administers a single pooled investment program comprising both an internal investment pool and an external investment pool (the Local Agency Investment Fund). There is a single portfolio of investments with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner as described below. In addition, certain programs have the authority to separately invest their funds.

The State's pooled investment program and certain other programs of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to have investments in United States government securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds, and other investments.

The State Treasurer's Office administers a pooled investment program for the primary government and for certain special purpose authorities. As of June 30, the special purpose authorities' cash and pooled investments were approximately 3% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. The State Treasurer's Office maintains cash deposits with certain banks that do not earn interest income. Income earned on these deposits compensates the banks for services and uncleared checks that are deposited in the pooled investment program's accounts.

All demand and time deposits, totaling approximately \$2.3 billion, which were held by financial institutions as of June 30, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or by an agent of the State Treasurer's Office in the State's name. The California Government Code requires collateral pledged for demand and time deposits to be deposited with the State Treasurer.

As of June 30, the State Treasurer's Office had amounts on deposit with fiscal agents totaling approximately \$24 million. These deposits are related to principal and interest payments due to bondholders. The majority of these deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of all securities in the State Treasurer's Office pooled investment program is based on quoted market prices. As of June 30, the average remaining life of the securities in the pooled money investment program administered by the State Treasurer's Office was approximately 210 days.

The Pooled Money Investment Board provides regulatory oversight over the State Treasurer's pooled investment program. The purpose of the Board is to design an effective cash management and investment program, using all monies flowing through the State Treasurer's Office bank accounts and keeping all available funds invested consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer, as chair; the State Controller; and the Director of Finance. This Board designates the amounts of temporarily idle money available for investment. The State Treasurer is charged with making the actual investment transactions for this investment program. This program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits of the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 1999, this difference was immaterial to the valuation of the program. The pool is run with a "dollar-in, dollar-out" participation. There are no share value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled money investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, they are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is all voluntary.

Certain funds, which have deposits in the State Treasurer's pooled investment program, do not receive the interest earnings on their deposits. The earnings on the investments related to those funds are legally required to be assigned to the State's General Fund. A major portion of the \$309 million interest revenue received by the General Fund from the pooled money investment program comes from these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants on a quarterly basis based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest

income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair value of the pool's investments. Since the total difference between the fair values of the investments in the pool and the values distributed to pool participants using the amortized cost method described above is not material, no adjustment was made to the financial statements.

The State Treasurer's Office reports participant fair value as a ratio of amortized cost on a quarterly basis, with the June 30 valuation being externally audited. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

The fair value, the ranges of interest rates, and the maturity dates of each major investment classification in the State Treasurer's pooled investment program are summarized in Table 4.

Tables 2 and 3 present summary financial statements of the Local Agency Investment Fund (LAIF), an Investment Trust Fund.

Table 2

Condensed Statement of Net Assets – LAIF

June 30, 1999

(Amounts in thousands)

Assets	
Cash and pooled investments.....	\$ 14,156,789
Due from other funds.....	188,508
Total Assets.....	\$ 14,345,297
Liabilities	
Due to other funds.....	\$ 595
Due to other governments.....	187,913
Other liabilities.....	1,965
Total liabilities.....	190,473
Net Assets Held in Trust for Pool Participants.....	\$ 14,154,824

Table 3**Condensed Statement of Changes in Net Assets – LAIF**

Year Ended June 30, 1999

(Amounts in thousands)

Changes in Net Assets Resulting from Operations.....	\$ 751,108
Distributions to Participants.....	(751,108)
Changes in Net Assets Resulting from Depositor Transactions.....	2,422,297
Total Change in Net Assets.....	2,422,297
Net Assets Held in Trust for Pool Participants, July 1, 1998.....	11,732,527
Net Assets Held in Trust for Pool Participants, June 30, 1999.....	\$ 14,154,824

As of June 30, floating rate notes and mortgage-backed assets comprised less than 4.8% of the pooled investments. For the floating rate notes in the portfolio, the interest received by the State Treasurer's pooled investment program will rise or fall as the underlying index rate rises or falls. The structure of the floating rate notes in the State Treasurer's pooled investment program portfolio is such that it hedges the portfolio against the risk of increasing interest rates. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs). A REMIC is a security backed by a pool of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule.

The California Government Code allows the State Treasurer's Office to enter into reverse repurchase agreements as part of its pooled investment program. A reverse repurchase agreement is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the State Treasurer's Office or provide securities or cash of equal value, the State Treasurer's pooled investment program will suffer an economic loss equal to the difference between the market value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, the State Treasurer's Office entered into 58 reverse repurchase agreements by temporarily selling investments with a carrying value of approximately \$5.5 billion. The maturities of investments made with the proceeds from reverse repurchase agreements were matched to the maturities of the agreements. As of June 30, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

Enterprise funds, internal service funds, trust and agency funds, a special revenue fund, and a building authority in the capital projects funds also make separate investments, which are presented

at fair value. The California Public Employees' Retirement System (CalPERS) and California State Teachers' Retirement System (CalSTRS) had \$284.5 billion in these separately invested funds.

CalPERS and CalSTRS exercise their authority under the State Constitution to invest in stocks, bonds, mortgages, real estate, and other investments.

The fair value of CalPERS' investments in securities is generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at that fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

CalPERS' mortgages are valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals. Short-term investments are reported at market value, when available, or at cost plus accrued interest, which approximates market value when market values are not available. For investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, has determined the fair values for the individual investments.

Under the State Constitution and statutory provisions governing CalPERS investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. Futures and options of approximately \$141 million were held for investment purposes as of June 30, 1999. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in net assets. Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 1999, CalPERS had approximately \$144 million net exposure to loss from forward foreign currency exchange transactions related to the \$35.8 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

The fair value of investments for CalSTRS is generally based on published market prices and quotations from major investment

firms. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair value represents the most recent appraisals. Short-term investments are reported at cost, or amortized cost, which approximates fair value.

Purchases and sales of debt securities, equity securities, and short term investments by CalSTRS are recorded on the trade date. Real estate equity transactions are recorded on the settlement date.

The State Constitution, state statutes, and agency policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third party securities lending agents have been contracted to lend domestic and international equity and debt securities. All securities loans can be terminated on demand by the lender or the borrower. Collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. As of June 30, 1999, there was no credit risk of exposure to borrowers because the amount of collateral held exceeded the amounts owed to the borrowers. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The contracts with the securities lending agents require them to indemnify CalPERS and CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrower fails to pay for income distributions by the securities' issuers while the securities are on loan.

For CalPERS, the average term of the overall loans managed by its two securities lending agents was 44 days and 56 days, respectively. In accordance with CalPERS investment guidelines, the cash collateral was invested in short-term investment funds that at June 30, 1999, had weighted average maturities of 234 days and 56 days, respectively.

For CalSTRS, cash collateral received on each security loan was invested in short-term investments that at June 30, 1999, had a weighted-average maturity of less than 90 days.

As of June 30, the State, including discretely presented component units, had investments in securities lending agreements, real estate,

investment contracts, mutual funds, and other investments totaling \$60.9 billion. These investments are not subject to classification. All remaining investments reported as of June 30 are categorized in three categories of credit risk:

1. Insured or registered, or securities held by the State or its agent in the State's name.
2. Uninsured and unregistered, with securities held by the counterparty's trust department or by an agent in the State's name.
3. Uninsured and unregistered, with securities held by the counterparty or by its trust department or by an agent but not in the State's name.

The types of investments reported at year end are representative of the types of investments made during the year. Furthermore, the credit risk associated with the investments reported at year end is representative of the credit risk associated with investments made during the year.

Table 4 presents the risk categories of the primary government as of June 30.

Table 4**Schedule of Investments – Primary Government**

June 30, 1999

(Amounts in thousands)

	Interest Rates	Maturity	Category			Total Fair Value
			1	2	3	
Pooled Investments *						
U.S. government securities.....	4.06 – 5.81	1 day – 5 years+	\$ 13,518,791	\$ —	\$ —	\$ 13,518,791
Negotiable certificates of deposit....	4.88 – 5.60	1 day – 1 year	5,553,884	—	—	5,553,884
Commercial paper.....	4.80 – 5.50	1 day – 180 days	10,062,569	—	—	10,062,569
Corporate bonds.....	4.85 – 6.04	1 day – 5 years+	2,302,491	—	—	2,302,491
Bank notes.....	4.88 – 5.60	1 day – 1 year	1,265,047	—	—	1,265,047
Total Pooled Investments.....			32,702,782	—	—	32,702,782
Separately Invested Funds Subject to Categorization						
Equity securities.....			156,091,802	—	—	156,091,802
Securities lending collateral.....			27,071,713	—	—	27,071,713
Mortgage loans and notes.....			17,973,441	—	—	17,973,441
U.S. government and agencies.....			9,701,994	74,057	—	9,776,051
Debt securities – STRS.....			18,560,015	—	—	18,560,015
Corporate bonds.....			6,456,647	—	—	6,456,647
Commercial paper.....			1,659,911	—	—	1,659,911
Other investments.....			7,301,608	157	262	7,302,027
Total Separately Invested Funds Subject To Categorization.....			244,817,131	74,214	262	244,891,607
Separately Invested Funds Not Subject to Categorization						
Investments held by broker-dealers under securities						
loans with cash collateral.....						26,416,644
Real estate.....						9,759,007
Venture capital and private equity funds.....						4,774,018
Investment contracts.....						3,234,166
Mutual funds.....						2,198,786
Mortgage loans.....						295,683
Other.....						2,610,460
Total Separately Invested Funds Not Subject to Categorization.....						49,288,764
Total Investments.....			\$ 277,519,913	\$ 74,214	\$ 262	\$ 326,883,153

* Approximately 3% of the pooled investments are investments of special purpose authorities which are discretely presented component units.
For special purpose authorities' separately invested funds, see Table 6.

The investments of the University of California, a discretely presented component unit, are stated at fair value. All of the University's investments recorded in each fund group are associated with the University of California Retirement System (UCRS), General Endowment Pool (GEP), High Income Pool (HIP), or Short Term Investment Pool (STIP) or are separately invested. Investments authorized by the Regents for the UCRS, GEP, HIP, and other separate investments include equities and fixed income securities. The equity portion of the investment portfolio may include both domestic and foreign common and preferred stocks, along with alternative equities. Alternative equities include venture capital partnerships, buy-out funds, and emerging market funds. Where donor agreements place constraints on allowable investments, assets associated with endowment and similar funds are invested in accordance with the terms of the agreements. Investments

authorized by the Regents for the STIP include fixed income securities with a maximum maturity of five years. In addition, the Regents have also authorized loans with terms up to 30 years, primarily to faculty members, under the University's Mortgage Origination Program.

The GEP and HIP are balanced portfolios in which a large number of individual endowment funds participate in order to benefit from diversification and economies of scale. The net assets of the endowment and similar funds group are invested in either the GEP, HIP, or STIP or are separately invested. The separately invested funds cannot be pooled due to investment restrictions or income requirements. All of the University of California's fund groups participate in the STIP. Current funds to provide for the payroll, operating expenses, and construction expenditures of all campuses and medical centers are invested in the STIP until expended.

The UCRS contains funds associated with the University of California's defined benefit and defined contribution plans.

The University of California participates in a securities lending program as a means to augment income. Securities are lent to brokerage firms for which collateral is received in excess of the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U. S. Government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the University unless the borrower defaults. Loans of domestic equities and all fixed income securities are initially collateralized at 102% of the fair value of securities lent. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of securities lent. The University receives interest and dividends during the loan period as well as a fee from the brokerage firm. Securities on loan for cash collateral are not considered to be categorized. As of June 30, the University had no credit risk exposure to borrowers because the amounts the University owed the borrowers exceeded the amounts the borrowers owed the University. The University is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the University or the borrower. Cash collateral is invested by the University's lending agent, as an agent for the University, in a short term investment pool in the University's name with guidelines approved by the Treasurer of the Regents. As of June 30, the securities in this pool had a weighted average maturity of 164 days. Table 5 presents risk categories of the University of California investments as of June 30.

Table 5**Schedule of Investments – University of California – Discretely Presented Component Unit**

June 30, 1999

(Amounts in thousands)

	Category			Total
	1	2	3	Fair Value
Separately Invested Funds Subject to Categorization				
Equity securities.....	\$ 27,169,386	\$ —	\$ —	\$ 27,169,386
Securities lending collateral.....	8,327,714	—	—	8,327,714
U.S. government and agency securities.....	5,354,401	—	—	5,354,401
Corporate bonds.....	7,184,691	—	—	7,184,691
Other investments.....	3,235,911	—	—	3,235,911
Total Separately Invested Funds Subject to Categorization.....	51,272,103	—	—	51,272,103
Separately Invested Funds Not Subject to Categorization				
Investments held by broker-dealers under securities loans				
with cash collateral.....				8,203,001
Venture capital and private equity funds.....				1,739,212
Insurance contracts.....				236,446
Mortgage loans.....				247,299
Other investments.....				185,843
Total Separately Invested Funds Not Subject to Categorization.....				10,611,801
Total Investments.....	\$ 51,272,103	\$ —	\$ —	\$ 61,883,904

The cash and pooled investments of the special purpose authorities, which are discretely presented component units, are primarily invested in the State Treasurer's pooled investment program. Additionally, state law, bond resolutions, and investment policy resolutions allow the authorities to invest in United States government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, and other investments.

The California Housing Finance Agency (CHFA), a discretely presented component unit, entered into interest rate caps and swap options to manage its interest rate exposure in connection with certain fixed rate loans and loan commitments that are financed with pending fixed or variable rate bond issues. As of June 30, 1999, the CHFA had interest rate cap and interest rate swap option agreements on notional amounts of \$171 million. All underlying bonds have been redeemed and the agreements, although available to the CHFA to offset certain interest rate exposures, ceased to be hedging transactions and are reported at fair value as of June 30, 1999 as investments. Revenues and expenses related to these transactions are recognized as incurred. The CHFA is potentially exposed to loss in the event the counterparties are unable to perform to the terms of the agreements. However, the CHFA does not anticipate nonperformance by the counterparties.

Table 6 presents the risk categories of the special purpose authorities investments outside of the State Treasurer's pooled investment program, as of June 30, 1999. Included in the investments of the special purpose authorities are the investments of the SCIF as of December 31, 1998. The SCIF represents 83% of the fair value of the authorities' investments.

Table 6**Schedule of Investments – Special Purpose Authorities – Discretely Presented Component Units ***

June 30, 1999

(Amounts in thousands)

	Category			Total Fair Value
	1	2	3	
Separately Invested Funds Subject to Categorization				
U.S. government securities.....	\$ 2,509,308	\$ —	\$ —	\$ 2,509,308
Corporate bonds.....	2,939,201	—	—	2,939,201
Mortgage loans and notes.....	884,332	—	—	884,332
Commercial paper.....	29,912	—	—	29,912
Investment agreements.....	—	172,641	—	172,641
Other investments.....	69,326	—	—	69,326
Total Separately Invested Funds Subject to Categorization.....	6,432,079	172,641	—	6,604,720
Separately Invested Funds Not Subject to Categorization				
Investment agreements.....				998,152
Mutual funds.....				26,112
Total Separately Invested Funds Not Subject to Categorization.....				1,024,264
Total Investments.....	\$ 6,432,079	\$ 172,641	\$ —	\$ 7,628,984

* For special purpose authorities' pooled investments, see Table 4.

**DUE FROM OTHER FUNDS, DUE TO OTHER FUNDS,
ADVANCES AND LOANS RECEIVABLE, ADVANCES FROM
OTHER FUNDS, DUE FROM PRIMARY GOVERNMENT,
AND DUE TO COMPONENT UNITS**

NOTE 4.

The balances of Due from Other Funds, Due to Other Funds, Advances and Loans Receivable, Advances from Other Funds, Due from Primary Government, and Due to Component Units are shown in Table 7. The total Advances and Loans Receivable of \$11.1 billion is more than the total Advances from Other Funds of \$1.0 billion because \$10.1 billion of loans to other governmental entities and individuals are included in the loans receivable amounts.

Table 7

Schedule of Due from Other Funds, Due to Other Funds, Advances and Loans Receivable, Advances from Other Funds, Due from Primary Government, and Due to Component Units

June 30, 1999 (Amounts in thousands)

	Due from Other Funds	Due to Other Funds	Advances and Loans Receivable	Advances from Other Funds	Due from Primary Government	Due to Component Units
General Fund.....	\$ 5,498,027	\$ 2,073,164	\$ 419,443	\$ 483,893	\$ —	\$ 69,804
Special Revenue						
Federal.....	704,564	3,800,311	41,354	—	—	—
Transportation Construction.....	1,229,739	104,358	6,160	—	—	121
Transportation Safety.....	77,389	371,498	—	—	—	—
Business and Professions						
Regulatory and Licensing.....	56,723	46,061	1,434	—	—	—
Environmental and						
Natural Resources.....	104,166	81,796	1,429,732	49,132	—	—
Financing to Local Governments.....	116,506	129,004	—	—	—	—
Cigarette and Tobacco Tax.....	257,794	204,122	—	—	—	92,259
Local Revenue.....	193,908	32,552	—	—	—	—
Unemployment Programs.....	569,774	70,020	—	—	—	—
Financing to the Public.....	550	20,165	33,810	—	—	—
Trial Courts.....	91,596	60,770	9,015	502	—	—
Other Special Revenue.....	106,046	56,588	1,732	12,015	—	3,639
Total Special Revenue.....	3,508,755	4,977,245	1,523,237	61,649	—	96,019
Capital Projects						
Prison Construction.....	1,236	271	—	—	—	—
Higher Education Construction.....	1,482	42,859	—	—	—	—
Natural Resources Acquisition and						
Enhancement.....	30,612	177	—	—	—	—
Building Authorities.....	110,170	62,566	—	—	—	—
Other Capital Projects.....	2,593	533	—	—	—	—
Total Capital Projects.....	146,093	106,406	—	—	—	—
Enterprise						
Housing Loan.....	10,725	407	2,042,766	22,072	—	—
Water Resources.....	71,787	34,698	69,860	6	—	—
School Building Aid.....	—	—	160,047	—	—	—
Toll Facilities.....	1,163	17,255	16,802	6,160	—	—
California State University.....	20,995	17,612	2,803	2,803	—	—
Leasing of Public Assets.....	130,430	10,011	—	—	—	—
State Lottery.....	9,107	252,566	—	—	—	—
Health Facilities Construction						
Loan Insurance.....	3,887	218	67,077	—	—	—
Public Employees' Benefits.....	38	875	—	—	—	—
Other Enterprise.....	11,701	4,780	231,635	4,232	—	—
Total Enterprise.....	259,833	338,422	2,590,990	35,273	—	—
Internal Service						
Architecture Revolving.....	97,876	4,431	—	—	—	—
Service Revolving.....	74,271	134,405	—	—	—	—
Prison Industries.....	12,954	1,783	—	—	—	—
Stephen P. Teale Data Center.....	19,044	297	—	—	—	—
Health and Welfare Data Center.....	38,884	—	—	—	—	—
Water Resources Revolving.....	54,525	—	—	94,517	—	—
Public Employees' Health Care.....	2,879	6,971	—	—	—	—
Equipment Service.....	14,795	26,932	—	—	—	—
Other Internal Service.....	140	7,857	—	1,434	—	—
Total Internal Service.....	315,368	182,676	—	95,951	—	—

(Continued)

Table 7 (continued)

Schedule of Due from Other Funds, Due to Other Funds, Advances and Loans Receivable, Advances from Other Funds, Due From Primary Government, and Due to Component Units

June 30, 1999 (Amounts in thousands)

	Due from Other Funds	Due to Other Funds	Advances and Loans Receivable	Advances from Other Funds	Due from Primary Government	Due to Component Units
Expendable Trust						
Unemployment.....	35,576	92,725	—	—	—	—
School Employees.....	1,689	5,532	—	—	—	—
Unemployment Compensation						
Disability.....	30,811	14,961	—	—	—	—
California State University and						
Colleges Trust.....	15,365	31,127	—	—	—	—
Student Loan.....	—	649	—	—	—	—
Housing Loan.....	2,293	203	581,043	—	—	—
Unclaimed Property.....	—	4,922	483,893	—	—	—
Deferred Compensation Plan.....	36	577	—	—	—	—
Other Expendable Trust.....	20,587	3,345	—	—	—	900
Total Expendable Trust.....	106,357	154,041	1,064,936	—	—	900
Pension Trust						
Public Employees' Retirement.....	8,311	—	—	—	—	—
State Teachers' Retirement.....	6,822	5,193	—	—	—	—
Judges' Retirement.....	—	354	—	—	—	—
Judges' Retirement II.....	—	172	—	—	—	—
Legislators' Retirement.....	—	199	—	—	—	—
Volunteer Firefighters'.....	—	10	—	—	—	—
Total Pension Trust.....	15,133	5,928	—	—	—	—
Agency						
Revenue Collecting and						
Disbursing.....	5,144,032	6,735,026	295,956	295,956	—	—
Deposit.....	14,942	526,110	21,011	—	—	—
Departmental Trust.....	3,551	280	—	—	—	—
Other Agency.....	231,014	331,720	—	—	—	3,674
Total Agency.....	5,393,539	7,593,136	316,967	295,956	—	3,674
Investment Trust						
Local Agency Investment.....	188,508	595	—	—	—	—
Total Investment Trust.....	188,508	595	—	—	—	—
University of California						
Current Funds.....	104	122,672	—	—	166,664	—
Loan Funds.....	—	2,000	—	—	—	—
Endowment and Similar Funds.....	21,015	—	—	—	—	—
Plant Funds.....	1,316	19,335	—	—	—	—
Retirement System Funds.....	121,572	—	—	—	—	—
Total University of California.....	144,007	144,007	—	—	166,664	—
Special Purpose Authorities						
California Housing Finance Agency.....	—	—	5,153,597	—	—	—
Non-Major Component Units.....	—	—	—	—	3,733	—
Total Special Purpose Authorities..	—	—	5,153,597	—	3,733	—
Total.....	\$ 15,575,620	\$ 15,575,620	\$ 11,069,170	\$ 972,722	\$ 170,397	\$ 170,397

(Concluded)

NOTE 5.**RESTRICTED ASSETS**

Table 8 presents a summary of the legal restrictions on assets as of June 30. The restricted assets of the primary government are in the enterprise funds, except for \$1 million in the internal service funds.

Table 8**Schedule of Restricted Assets**

June 30, 1999

(Amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Funds	Other Assets
Primary Government				
Debt service.....	\$ 716,981	\$ 812,320	\$ 516	\$ 1,321
Construction.....	446,525	4,317	1,007	—
Deposits.....	4,425	—	—	—
Equipment repair and replacement.....	40,928	—	1,066	200
Operations.....	188	—	—	—
Other.....	9,879	—	—	—
Total Primary Government.....	1,218,926	816,637	2,589	1,521
Discretely Presented Component Units				
University of California				
Risk insurance.....	—	203,417	—	—
Debt service requirements.....	—	181,936	—	—
Plant acquisition, construction, and renovation.....	—	23,142	—	—
Plant renewal and replacement.....	—	442	—	—
Special Purpose Authorities				
Debt service.....	386,993	1,228,921	—	—
District fairs.....	23	—	—	—
Total Discretely Presented Component Units.....	387,016	1,637,858	—	—
Total All Restricted Assets.....	\$ 1,605,942	\$ 2,454,495	\$ 2,589	\$ 1,521

NOTE 6.**NET INVESTMENT IN DIRECT FINANCING LEASES**

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. Payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board.

The minimum lease payments to be received by the State Public Works Board for the primary government are summarized in Table 9.

Table 9

**Schedule of Minimum Lease Payments to be Received by the
State Public Works Board for the Primary Government**

(Amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Local Agencies	Total
2000.....	\$ 385,637	\$ 109,826	\$ 66,500	\$ 561,963
2001.....	367,100	107,586	68,591	543,277
2002.....	358,894	105,987	66,887	531,768
2003.....	360,974	105,168	63,715	529,857
2004.....	357,092	105,264	65,869	528,225
Thereafter.....	4,003,782	1,373,282	627,088	6,004,152
Total Minimum Lease Payments.....	5,833,479	1,907,113	958,650	8,699,242
Less unearned income.....	2,517,330	847,119	396,497	3,760,946
Net Investment in Direct Financing Leases.....	\$ 3,316,149	\$ 1,059,994	\$ 562,153	\$ 4,938,296

NOTE 7.

FIXED ASSETS

Table 10 is a summary of changes in the General Fixed Assets Account Group for the year ended June 30. Included in the General Fixed Asset Account Group are fixed assets related to capital leases totaling \$3.9 billion.

Table 10

Schedule of Changes in General Fixed Assets

(Amounts in thousands)

	Balance July 1, 1998	Additions	Deductions	Balance June 30, 1999
Land.....	\$ 1,999,004	\$ 72,591	\$ 25,615	\$ 2,045,980
Structures and improvements.....	11,410,439	513,825	36,967	11,887,297
Equipment.....	1,814,596	285,774	143,901	1,956,469
Construction in progress....	1,547,446	619,673	611,338	1,555,781
Total.....	\$ 16,771,485	\$ 1,491,863	\$ 817,821	\$ 17,445,527

Table 11 summarizes the proprietary fund fixed assets of enterprise funds and internal service funds, and the fixed assets of the discretely presented component units as of June 30.

Table 11

Schedule of Fixed Assets for Proprietary Funds and Discretely Presented Component Units

June 30, 1999

(Amounts in thousands)

Primary Government	Enterprise	Internal Service
State water projects.....	\$ 4,482,759	\$ —
Toll facilities.....	1,148,072	—
Other land, improvements, buildings and equipment.....	992,353	1,063,487
Construction in progress.....	198,529	3,442
Total Primary Government Fixed Assets.....	6,821,713	1,066,929
Less: accumulated depreciation.....	1,936,209	552,269
Net Primary Government Fixed Assets.....	\$ 4,885,504	\$ 514,660
	University of California	Special Purpose Authorities
Discretely Presented Component Units		
Real estate		
Buildings and improvements.....	\$ 8,608,110	\$ 515,514
Land.....	308,995	44,642
Furniture and equipment.....	3,066,805	162,516
Libraries and collections.....	2,329,849	—
Construction in progress.....	888,684	797
Total Discretely Presented Component Unit Fixed Assets..	15,202,443	723,469
Less: accumulated depreciation.....	—	190,339
Net Discretely Presented Component Unit Fixed Assets.....	\$ 15,202,443	\$ 533,130

NOTE 8.**LONG-TERM OBLIGATIONS**

As of June 30, the primary government had long-term obligations totaling \$23.9 billion. These obligations are not expected to be financed from current resources in the governmental funds. Long-term obligations consist of the liability for employees' compensated absences, certificates of participation and commercial paper, long-term capital lease obligations, unmatured general obligation bonds, unmatured revenue bonds, and other liabilities. The other liabilities consist of \$765 million for workers' compensation claims, \$684 million for net pension obligations, \$425 million owed for lawsuits, and the University of California pension liability of \$101 million. These other liabilities do not have any required payment schedules, or will be paid when funds are appropriated. Of the total long-term obligations outstanding, 95% will be paid by the General Fund and 5% by special revenue funds. The changes in the General Long-Term Obligations Account Group during the year ended June 30, 1999, are summarized in Table 12.

Table 12**Schedule of Changes in General Long-Term Obligations**

(Amounts in thousands)

	Balance July 1, 1998	Additions	Deductions	Balance June 30, 1999
Compensated absences payable.....	\$ 1,003,960	\$ 695,964	\$ 642,021	\$ 1,057,903
Certificates of participation and commercial paper....	1,141,511	1,539,929	2,255,796	425,644
Capital lease obligations.....	3,546,867	83,295	189,959	3,440,203
General obligation bonds payable.....	14,894,090	2,295,926	1,022,986	16,167,030
Revenue bonds payable.....	759,440	62,220	11,360	810,300
Other liabilities.....	1,684,680	551,209	261,391	1,974,498
Totals.....	\$ 23,030,548	\$ 5,228,543	\$ 4,383,513	\$ 23,875,578

NOTE 9.**COMPENSATED ABSENCES**

As of June 30, the estimated liability for compensated absences related to accumulated vacation and annual leave totaled approximately \$1.6 billion. Of this amount, \$1.1 billion is reported in the General Long-Term Obligations Account Group, \$65 million is reported in the proprietary fund types, \$130 million is reported in the General Fund, and \$350 million is reported in the discretely presented component units.

NOTE 10.**CERTIFICATES OF PARTICIPATION**

Debt service requirements for certificates of participation, which are financed by lease payments from the special revenue funds and the General Fund, are shown in Table 13.

Table 13**Schedule of Debt Service Requirements for Certificates of Participation – Primary Government**

(Amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2000.....	\$ 7,516	\$ 6,729	\$ 14,245
2001.....	7,644	6,252	13,896
2002.....	7,395	6,487	13,882
2003.....	7,645	6,224	13,869
2004.....	7,711	6,139	13,850
Thereafter.....	70,733	56,614	127,347
Total.....	\$ 108,644	\$ 88,445	\$ 197,089

Debt service requirements for certificates of participation for the University of California, a discretely presented component unit, are shown in Table 14.

Table 14

Schedule of Debt Service Requirements for Certificates of Participation – University of California – Discretely Presented Component Unit
(Amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2000.....	\$ 8,285	\$ 15,979	\$ 24,264
2001.....	10,800	16,150	26,950
2002.....	10,045	15,692	25,737
2003.....	10,570	15,175	25,745
2004.....	11,205	14,482	25,687
Thereafter.....	262,245	150,215	412,460
Total.....	\$ 313,150	\$ 227,693	\$ 540,843

Prior Year Defeasance: In prior years, the primary government has defeased certificates of participation by placing the proceeds of new certificates in an irrevocable trust account to provide for all future debt service payments on the old certificates. Accordingly, the assets of the trust accounts and the liability for the defeased certificates are not included in the State's financial statements. At June 30, 1999, approximately \$69 million of prior year certificates of participation outstanding are considered defeased.

In prior years, the University of California, a discretely presented component unit, defeased certain certificates of participation. Investments that have maturities and interest rates sufficient to fund retirement of these liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liability for the defeased certificates of participation are not included in the State's financial statements. As of June 30, 1999, the outstanding balance of defeased certificates of participation for the University of California was approximately \$174 million.

NOTE 11.**COMMERCIAL PAPER AND OTHER BORROWINGS**

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program of up to \$2.0 billion and an enterprise fund commercial paper program for the Department of Water Resources of up to \$100 million. Under these programs, commercial paper may be issued at prevailing rates for periods not to exceed 270 days from the date of issuance.

To provide liquidity for the programs, a revolving credit agreement has been entered into with commercial banks equal to the authorized amount of commercial paper.

The current agreement, negotiated on December 31, 1998, established the existing \$2 billion limit on the amount of outstanding notes under the general obligation commercial paper program effective March 1, 1999. As of June 30, 1999, the general obligation commercial paper program had \$317 million in outstanding commercial paper notes and the enterprise fund commercial paper program had \$14 million in outstanding notes.

The proceeds from the issuance of commercial paper are restricted primarily to construction costs of general obligation bond program projects and of certain water projects. Because the general obligation commercial paper is retired by long-term general obligation debt, it is recorded in the General Long-Term Obligations Account Group.

The University of California, a discretely presented component unit, has mortgages and other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. The mortgages are secured by real property. Included in mortgages and other borrowings, which total approximately \$181 million, are various unsecured financing agreements with commercial banks that total approximately \$51 million.

The University of California established a \$550 million commercial paper program with tax-exempt and taxable components. The program is supported by either the legally available unrestricted cash balance in the University of California's Short Term Investment Pool, or by a revolving line of credit and term loan agreement with a syndicate of banking institutions. Commercial paper has been issued to provide for interim financing of construction and related equipment and medical center working capital requirements. Commercial paper is not secured by any encumbrance, mortgage, or other pledge of property and does not constitute a general obligation of the University of California Regents. At June 30, 1999, outstanding tax-exempt and taxable commercial paper was \$430 million and \$120 million, respectively.

NOTE 12.

LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30 is approximately \$7.0 billion. This amount does not include any future escalation charges for real estate taxes and operating expenses. Most primary government leases are classified as operating leases, in accordance with the applicable standards, and contain clauses providing for termination. It is expected that in the normal course of business most of these operating leases will be replaced by similar leases.

The total present value of minimum lease payments for the primary government is composed of approximately \$3.4 billion in the General Long-Term Obligations Account Group and \$74 million in internal service funds. Lease expenditures for the year ended June 30 amounted to approximately \$622 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of \$3.3 billion. This amount represents 94% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include \$784 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the leases, title will pass to the primary government. The costs of the buildings are reported in the General Fixed Assets Account Group and the revenue bonds and certificates of participation outstanding associated with the buildings are reported in the General Long-Term Obligations Account Group. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements pursuant to GASB Statement No. 14.

Future minimum lease commitments of the primary government are summarized in Table 15.

Table 15

Schedule of Future Minimum Lease Commitments – Primary Government

(Amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases		Total
		General Long-Term Obligations	Internal Service Funds	
2000.....	\$ 221,323	\$ 403,316	\$ 9,333	\$ 633,972
2001.....	180,034	382,506	9,638	572,178
2002.....	132,006	372,916	9,638	514,560
2003.....	74,917	375,006	9,582	459,505
2004.....	43,508	371,136	8,970	423,614
Thereafter.....	127,513	4,214,763	57,881	4,400,157
Total Minimum Lease Payments.....	\$ 779,301	6,119,643	105,042	\$ 7,003,986
Less amount representing interest.....		2,679,440	30,668	
Present Value of Net Minimum Lease Payments.....		\$ 3,440,203	\$ 74,374	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 1999, is approximately \$2.4 billion. Table 16 presents the future minimum lease commitments for the University of California and the special purpose authorities, as of June 30. Operating lease expenditures for the year ended June 30 amounted to approximately \$129 million for discretely presented component units.

Table 16

Schedule of Future Minimum Lease Commitments – Discretely Presented Component Units

(Amounts in thousands)

Year Ending June 30	University of California		Special Purpose Authorities		Total
	Capital	Operating	Capital	Operating	
2000.....	\$ 131,529	\$ 54,850	\$ 45	\$ 22,949	\$ 209,373
2001.....	124,988	47,577	40	17,369	189,974
2002.....	113,306	39,816	36	9,638	162,796
2003.....	108,713	33,049	10	7,143	148,915
2004.....	100,571	54,864	—	2,889	158,324
Thereafter.....	1,455,163	106,723	—	6,538	1,568,424
Total Minimum Lease Payments.....	2,034,270	\$ 336,879	131	\$ 66,526	\$ 2,437,806
Less amount representing interest.....	784,253		21		
Present Value of Net Minimum Lease Payments.....	\$ 1,250,017		\$ 110		

NOTE 13.

COMMITMENTS

The primary government has made commitments of \$2.9 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the special revenue funds because the future expenditures related to these commitments are expected to be reimbursed from local governments and proceeds of approved federal grants. The ultimate liability will not accrue to the State.

As of June 30, the primary government had other commitments totaling \$2.0 billion that are not included as a liability on the balance sheet. These commitments included loan and grant programs for housing, school building aid, and rail system construction totaling approximately \$1.3 billion. The total commitments also include approximately \$585 million for the construction of water projects and the purchase of power, and up to \$131 million for the operation and maintenance of the lottery's automated gaming system. The commitments are expected to be funded from existing program resources and from the proceeds of revenue and general obligation bonds to be issued.

As of June 30, the University of California and special purpose authorities, discretely presented component units, had other commitments that are not included as a liability on the balance sheet. The University of California had authorized construction projects totaling \$1.6 billion. Special purpose authorities had outstanding commitments to provide \$230 million for loans under various housing revenue bond programs.

NOTE 14.

GENERAL OBLIGATION BONDS

The State Constitution permits the primary government to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. The debt service for general obligation bonds is appropriated from the General Fund. Under the State Constitution, the General Fund is used first to support the public school system and public institutions of higher education. The General Fund can then be used to service the debt on outstanding general obligation bonds. Enterprise funds and certain other funds reimburse the General Fund for any debt service provided on their behalf.

General obligation bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included within the accounts of such funds in the financial statements. However, the General Fund may be liable for the payment of any principal and interest on these bonds that is not met from the resources of such funds.

As of June 30, \$13.2 billion of general obligation bonds had been authorized but not issued. This amount includes \$4.7 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, \$317 million in general obligation indebtedness has been issued in the form of commercial paper notes, but not yet retired by long-term bonds.

Table 17 summarizes the changes in general obligation bond debt for the year ended June 30.

Table 17**Schedule of Changes in General Obligation Bond Debt**

(Amounts in thousands)

	General Long-Term Obligations	Enterprise Funds	Total
Balance, July 1, 1998.....	\$ 14,894,090	\$ 4,016,865	\$ 18,910,955
Additions.....	2,295,926	—	2,295,926
Deductions.....	(1,022,986)	(300,750)	(1,323,736)
Balance, June 30, 1999.....	\$ 16,167,030	\$ 3,716,115	\$ 19,883,145

Table 18 shows the debt service requirements for all general obligation bonds, including interest of \$11.6 billion, as of June 30, 1999.

Table 18**Schedule of General Obligation Bonds Debt Service Requirements**

(Amounts in thousands)

Year Ending June 30	General Long-Term Obligations	Enterprise Funds
2000.....	\$ 2,001,170	\$ 355,528
2001.....	1,955,911	350,241
2002.....	1,903,240	366,633
2003.....	1,811,740	330,352
2004.....	1,670,272	342,478
Thereafter.....	15,780,428	4,627,241
Total.....	\$ 25,122,761	\$ 6,372,473

Current Year Defeasances: On October 21, 1998, the primary government issued approximately \$271 million in various purpose general obligation refunding bonds (the "1998 Bonds") for an advance refunding of approximately \$269 million in outstanding general obligation bonds maturing in years 2006 to 2014 (the "1998 Refunded Bonds"). The primary government invested the net proceeds of approximately \$295 million in U.S. government securities and placed the securities in an irrevocable trust to pay

debt service on the 1998 Refunded Bonds. As a result, the 1998 Refunded Bonds are considered to be defeased and the liability for those bonds has been removed from the General Long-Term Obligations Account Group. This advance refunding was undertaken to reduce total debt service payments through March 1, 2014, by approximately \$21 million and to obtain an economic gain (the difference between the present value of the debt service payments on the 1998 Bonds and the 1998 Refunded Bonds) of approximately \$14 million.

On March 11, 1999, the primary government issued approximately \$87 million in general obligation refunding bonds (the "1999 Bonds"), for an advance refunding of approximately \$87 million of outstanding general obligation bonds maturing in years 2005 to 2014 (the "1999 Refunded Bonds"). The State Treasurer invested the net proceeds of approximately \$93 million in U.S. government securities and placed the securities in an irrevocable trust to pay debt service on the 1999 Refunded Bonds. As a result, the 1999 Refunded Bonds are considered to be defeased and the related liabilities have been removed from the General Long-Term Obligations Accounts Group. The refunding will decrease the primary government's debt service payments through March 1, 2014 by approximately \$4 million. The refunding also resulted in an economic gain (the difference between the present value of the debt service payments on the 1999 Bonds and the 1999 Refunded Bonds) of approximately \$3 million.

During the year ended June 30, 1999, the primary government issued approximately \$351 million in veterans general obligation bonds, the proceeds of which were used to immediately refund previously issued veterans general obligation bonds of approximately \$351 million. In addition, approximately \$134 million of veterans general obligation bonds were refunded by veterans Home Purchase Revenue bonds (See Note 15 Revenue Bonds).

Prior Year Defeasance: In prior years, the primary government has placed the proceeds of the refunded bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on the defeased bonds. The assets of the trust accounts and the liability for the defeased bonds are not included in the State's financial statements. As of June 30, 1999, the outstanding balance of general obligation bonds defeased in prior years was approximately \$1.2 billion.

NOTE 15.**REVENUE BONDS**

Revenue bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included within the accounts of such funds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds of the authorities and agencies listed in the next section of this note. The General Fund has no legal liability for payment of principal and interest on revenue bonds.

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance are issued for Water Resources, California State University, and Leasing of Public Assets. Revenue bonds are also issued to make loans to finance the acquisition of farms and homes by California veterans. When the farm and home loans financed by the revenue bonds are fully paid, the farms and homes become the property of private individuals.

Certain building authorities, under state law, may issue revenue bonds. These revenue bonds are included in the General Long-Term Obligations Account Group. These bonds are issued for the purpose of acquiring and constructing buildings for public education purposes and for the purpose of constructing state office buildings. Leases with state agencies pay the principal and interest on the revenue bonds issued by the building authorities. The primary government has no legal liability for the payment of principal and interest on these revenue bonds.

The University of California, a discretely presented component unit, issues revenue bonds to finance the construction, renovation, and acquisition of certain facilities and equipment.

Under state law, a special purpose authority, which is a discretely presented component unit, issues revenue bonds to make loans to finance housing developments and to finance the acquisition of homes by low to moderate income families. When the housing developments and home loans are fully paid, the housing developments and homes become the property of private individuals or entities.

Table 19 shows revenue bonds outstanding as of June 30.

Table 19**Schedule of Revenue Bonds Outstanding**

June 30, 1999

(Amounts in thousands)

Primary Government	
Enterprise Funds	
Housing Loan.....	\$ 404,215
Water Resources.....	2,454,672
California State University.....	543,983
Leasing of Public Assets.....	5,504,652
Total Enterprise Funds.....	8,907,522
General Long-Term Obligations	
Building Authorities	
California State University.....	30,680
Los Angeles.....	153,605
San Francisco.....	392,505
San Bernardino.....	62,220
Oakland.....	157,820
Riverside.....	13,470
Total General Long-Term Obligations.....	810,300
Total Primary Government.....	9,717,822
Discretely Presented Component Units	
University of California.....	2,504,395
Special Purpose Authorities.....	6,001,366
Total Discretely Presented Component Units.....	8,505,761
Total.....	\$ 18,223,583

Table 20 shows the debt service requirements as of June 30, 1999. The debt service requirements primarily represent bond principal payments. Table 20 also includes certain unamortized refunding costs, premiums, discounts, and other costs not included in Table 19.

Table 20**Schedule of Revenue Bond Debt Service Requirements**

(Amounts in thousands)

Year Ending June 30	Primary Government		Discretely Presented Component Units
	General Long-Term Obligations	Enterprise Funds	
2000.....	\$ 25,495	\$ 332,997	\$ 212,163
2001.....	27,380	355,700	169,322
2002.....	28,650	335,076	192,012
2003.....	29,940	340,915	204,407
2004.....	31,350	339,835	211,632
Thereafter.....	667,485	7,534,762	7,532,978
Total.....	\$ 810,300	\$ 9,239,285	\$ 8,522,514

Current Year Defeasances: For the year ended June 30, 1999, the primary government issued approximately \$35 million in revenue bonds for Leasing of Public Assets to refund approximately \$35 million of outstanding lease revenue bonds. The net proceeds of approximately \$3 million, after payment of \$51,709 for the original discount, underwriter discount, insurance, and other bond issuance costs, and receipts of approximately \$8 million for original bond premium together with other available moneys of approximately \$1 million were deposited in various escrow accounts held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The advance refunding reduced the primary government's aggregate debt service by approximately \$1 million over the next three years and resulted in an economic gain of \$146,501.

The primary government also issued approximately \$185 million in revenue bonds for Leasing of Public Assets to advance refund approximately \$180 million of outstanding lease revenue bonds. The net proceeds of approximately \$188 million, after payment of approximately \$2 million in underwriter discount, original bond discount, insurance, and other bond issuance costs, and receipt of approximately \$6 million for original bond premium together with other available moneys of \$9 million were deposited in various escrow accounts held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The advance refunding reduced the primary government's aggregate debt service payments by \$18 million over the next 20 years and resulted in an economic gain of \$6 million.

For the year ended June 30, 1999, the primary government issued approximately \$240 million of Home Purchase Revenue Bonds, certain portions of which were used to refund approximately \$106 million of outstanding Home Purchase Revenue Bonds and \$134 million of outstanding veterans general obligation bonds. Net proceeds were deposited in various escrow accounts held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

In November 1998, the primary government issued \$207 million in Central Valley Project (CVP) Water System Revenue Bonds - Series U, a portion of which was used to advance refund \$99 million of outstanding bonds. In November 1998, the primary government issued \$21 million in CVP Water System Revenue Bonds - Series V, a portion of which was used to advance refund \$21 million of outstanding bonds. Although the fiscal year 1998-1999 advance refunding resulted in the recognition of an accounting loss of \$5 million, the primary government effectively reduced its aggregate

debt service payments by approximately \$7 million over the next 30 years and obtained an economic gain of approximately \$4 million. The net proceeds of the advance refundings (after payment of underwriting refunding fees, other issuance costs, and deposits to debt service reserve accounts) were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded bonds. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

For the year ended June 30, 1999, the California Housing Finance Agency (CHFA), a discretely presented component unit, issued \$279 million of single family and multifamily housing bonds, portions of which were used to redeem \$273 million in outstanding single family and multifamily housing bonds. The refunding will decrease the debt service cash flow for the housing bonds by approximately \$169 million. The refunding also resulted in an economic gain of approximately \$82 million. The CHFA considered these debt refundings to be an in-substance defeasance and accordingly, removed the redeemed bonds and related assets from the financial statements.

Prior Year Defeasances: In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, 1999, the outstanding balance of revenue bonds defeased in prior years was approximately \$2.5 billion.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, 1999, the outstanding balance of University of California revenue bonds defeased in prior years was \$866 million.

NOTE 16.

MAJOR TAX REVENUES

Tax revenues for the year ended June 30, 1999, are presented in Table 21.

Table 21

Schedule of Major Tax Revenues

Year Ended June 30, 1999

(Amounts in thousands)

	General Fund	Special Revenue Funds	Expendable Trust Funds
Personal income.....	\$ 30,862,872	\$ —	\$ —
Sales and use.....	18,929,048	3,949,268	—
Bank and corporation.....	5,421,742	—	—
Unemployment insurance.....	—	—	2,897,617
Disability insurance.....	—	—	1,276,691
Insurance.....	1,272,953	—	—
Inheritance, estate, and gift.....	1,034,980	—	—
Cigarette and tobacco.....	150,091	825,391	—
Other.....	302,810	313,577	38,546
Total.....	\$ 57,974,496	\$ 5,088,236	\$ 4,212,854

NOTE 17.

FUND EQUITY

A. Fund Deficits

The following funds had deficits at June 30, 1999, as shown in Table 22.

Table 22

Schedule of Fund Deficits

June 30, 1999

(Amounts in thousands)

	Special Revenue Funds	Capital Projects Funds	Internal Service Funds
Financing to Local Governments.....	\$ 39,408	\$ —	\$ —
Local Revenue.....	2,439	—	—
Higher Education Construction.....	—	60,018	—
Los Angeles Building Authority.....	—	34,693	—
Water Resources Revolving.....	—	—	26,040
Architecture Revolving.....	—	—	4,650
Total.....	\$ 41,847	\$ 94,711	\$ 30,690

**B. Changes to
Contributed Capital**

The changes in the State's contributed capital accounts are shown in Table 23.

Table 23**Schedule of Changes in Contributed Capital**

(Amounts in thousands)

	Enterprise Fund's	Internal Service Funds	Discretely Presented Component Units	Total
Balance, July 1, 1998.....	\$ 195,233	\$ 344,184	\$ 99	\$ 539,516
Government contributions.....	52,424	1,007	10	53,441
Decreases.....	—	(8)	—	(8)
Balance, June 30, 1999.....	\$ 247,657	\$ 345,183	\$ 109	\$ 592,949

NOTE 18.**RISK MANAGEMENT**

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. Generally, the exceptions are when a bond resolution or a contract requires the primary government to purchase commercial insurance for coverage against property loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, there has been no insurance settlement in the last three years that has exceeded insurance coverage. The primary government generally does not maintain reserves. Losses are covered in the year in which the payment occurs by appropriations from each fund responsible for payment. All claim payments are on a "pay as you go" basis with workers' compensation benefits for self-insured agencies being initially paid by the SCIF. The potential amount of loss arising from risks other than workers' compensation benefits is not considered material in relation to the primary government's financial position.

The discounted liability for unpaid self-insured worker's compensation losses is estimated to be \$990 million as of June 30, 1999. This estimate is based on an actuarial review of the State's employee worker's compensation program and includes indemnity payments to claimants, as well as all other costs of providing worker's compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, Industrial Disability Leave benefits, and incurred but not reported amounts. The estimated total liability of approximately \$1.4 billion is discounted using a 5.0% interest rate. Of the total, \$130 million is included in the General Fund, \$79 million in the special revenue fund type, \$16 million in the proprietary fund types, and \$765 million in the General Long-Term Obligations Account Group. Changes in the claims liabilities during the year ended June 30 are shown in Table 24.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based upon an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 6.25% to 8.0%. The special purpose authorities, which are discretely presented component units, do not have any significant liabilities related to self insurance.

Table 24**Schedule of Changes in the Self Insurance Claims**

Years Ended June 30
(Amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	1999	1998	1999	1998
Unpaid claims, beginning.....	\$ 886,000	\$ 869,000	\$ 319,300	\$ 324,800
Incurred claims.....	345,000	240,000	174,600	173,800
Claim payments.....	(241,000)	(223,000)	(163,900)	(179,300)
Unpaid claims, ending.....	<u>\$ 990,000</u>	<u>\$ 886,000</u>	<u>\$ 330,000</u>	<u>\$ 319,300</u>

NOTE 19.**SEGMENT INFORMATION**

Selected financial information by enterprise fund activity for major segments is shown in Table 25. The primary sources of enterprise fund revenues are as follows.

Housing Loans: Interest charged on contracts of sale of properties to California veterans and to California National Guard members; loan origination fees; and interest on investments.

Water Resources: Charges to local water districts, sale of excess power to public utilities, and interest earned on investments.

School Building Aid: Interest charged on loans to school districts for acquisition, construction, or rehabilitation of classroom facilities; and income from the rental of portable classrooms to school districts.

Toll Facilities: Toll fees and interest earned on investments.

California State University: Charges to students for housing and parking; student fees for campus unions, health centers, and self-

supporting educational programs; and interest earned on investments.

Leasing of Public Assets: Rental charges from the lease of public assets and interest earned on investments.

State Lottery: Sale of lottery tickets.

Health Facilities Construction Loan Insurance: Construction project fees and income from loan insurance premiums and operations or proceeds of sales of property acquired by default of borrowers.

Public Employees' Benefits: Contributions for public employee long-term care plans and fees for managing a deferred compensation program.

Other Enterprise: Canteen revenues and fees charged by various other departments.

Table 25

Schedule of Enterprise Fund Activity by Separate Major Segments

As of and for the Year Ended June 30, 1999

(Amounts in thousands)

	Housing Loan	Water Resources	School Building Aid	Toll Facilities	California State University	Leasing of Public Assets	State Lottery	Health Facilities Construction Loan Insurance	Public Employees' Benefits	Other Enterprise
Operating revenue.....	\$ 223,332	\$ 619,187	\$ 25,962	\$ 3,906	\$ 279,467	\$ 401,318	\$ 2,498,298	\$ 37,599	\$ 135,770	\$ 120,226
Depreciation.....	1,042	75,176	3,720	17,394	—	—	5,468	—	—	17
Amortization of deferred charges.....	—	118,871	—	430	—	5,993	1,709	—	—	—
Operating income (loss).....	(9,865)	92,390	10,754	(17,010)	41,880	21,170	849,780	17,763	15,583	27,763
Operating transfers in.....	6,840	—	3,392	—	20,143	838	—	—	—	17,496
Operating transfers out.....	887	—	—	—	48,725	—	—	—	—	215
Net income (loss).....	(5,237)	(80,830)	14,146	(640,014)	9,512	22,008	—	25,214	55,404	60,843
Grants received.....	—	—	—	—	277	—	—	—	—	—
Grants provided.....	—	—	—	625,946	—	—	—	—	—	—
Property, plant, and equipment										
Additions.....	—	126,937	—	9,339	46,885	126,588	2,447	—	—	64
Deductions.....	1,042	75,176	3,720	17,394	—	—	5,593	14	—	17
Net working capital.....	1,369,973	185,281	39,142	58,985	482,233	552,739	(41,189)	158,412	381,991	207,670
Total assets.....	3,502,362	4,932,222	264,072	695,014	1,367,308	5,772,327	3,390,136	238,726	388,454	546,521
Bonds and other long-term liabilities.....	3,156,830	3,656,067	2,500	6,160	557,537	5,504,652	2,617,075	181,666	312,635	46,764
Total Equity (Deficit).....	288,705	1,019,221	261,568	663,911	720,242	160,441	—	51,832	69,356	393,509

NOTE 20.

**CONDENSED FINANCIAL STATEMENTS -
DISCRETELY PRESENTED COMPONENT UNITS**

Tables 26 and 27 present summary financial statements of the special purpose authorities, which are the SCIF, the CHFA, and Non-Major Component Units. The financial statements of the University of California, a discretely presented component unit, are presented separately in the combined statements of this report.

The SCIF is a component unit created to offer insurance protection to employers at the lowest possible cost. This information is as of and for the year ended December 31, 1998. The CHFA was created for the purpose of meeting the housing needs of persons and families of low and moderate income. The Non-Major Component Units provide certain services that are not part of the primary government and also provide certain private and public entities with a low-cost source of financing for activities that are deemed to be in the public interest.

Table 26

**Condensed Balance Sheet – Special Purpose Authorities –
Discretely Presented Component Units**

June 30, 1999

(Amounts in thousands)

	State Compensation Insurance Fund	California Housing Finance Agency	Non-Major Component Units	Total
Assets				
Due from primary government.....	\$ —	\$ —	\$ 3,733	\$ 3,733
Other current assets.....	1,508,976	534,855	195,985	2,239,816
Investments.....	6,353,957	1,212,674	62,353	7,628,984
Advances and loans receivable.....	—	5,153,597	—	5,153,597
Fixed assets.....	223,372	—	309,758	533,130
Total Assets.....	\$ 8,086,305	\$ 6,901,126	\$ 571,829	\$ 15,559,260
Liabilities				
Other current liabilities.....	\$ 1,263,239	\$ 334,484	\$ 15,137	\$ 1,612,860
Benefits payable.....	4,905,961	—	—	4,905,961
Revenue bonds payable.....	—	5,902,315	99,051	6,001,366
Contracts and notes payable..	—	—	4,056	4,056
Total Liabilities.....	6,169,200	6,236,799	118,244	12,524,243
Fund Equity				
Contributed capital.....	—	—	109	109
Retained earnings				
Reserved for regulatory requirements.....	—	592,099	—	592,099
Unreserved.....	1,917,105	72,228	453,476	2,442,809
Total Fund Equity.....	1,917,105	664,327	453,585	3,035,017
Total Liabilities and Fund Equity.....	\$ 8,086,305	\$ 6,901,126	\$ 571,829	\$ 15,559,260

Table 27

Condensed Statement of Revenues, Expenses, and Changes in Retained Earnings – Special Purpose Authorities – Discretely Presented Component Units

Year Ended June 30, 1999

(Amounts in thousands)

	State Compensation Insurance Fund	California Housing Finance Agency	Non-Major Component Units	Total
Operating Revenues				
Earned premiums (net).....	\$ 1,211,115	\$ —	\$ —	\$ 1,211,115
Other revenue.....	44,666	384,687	192,364	621,717
Total Operating Revenues..	1,255,781	384,687	192,364	1,832,832
Operating Expenses				
Depreciation.....	8,737	429	3,142	12,308
Benefit payments.....	1,444,727	—	—	1,444,727
Interest expense.....	—	357,512	3,203	360,715
Amortization of deferred charges.....	165,668	1,839	—	167,507
Other operating expenses.....	71,265	49,345	135,983	256,593
Total Operating Expenses...	1,690,397	409,125	142,328	2,241,850
Operating Income (Loss).....	(434,616)	(24,438)	50,036	(409,018)
Nonoperating Revenues (Expenses)				
Investment and interest income.....	581,379	83,718	5,052	670,149
Dividends paid.....	(122,759)	—	—	(122,759)
Other nonoperating revenues (expenses), net..	—	—	(34,436)	(34,436)
Net Nonoperating Revenues (Expenses).....	458,620	83,718	(29,384)	512,954
Net Income.....	24,004	59,280	20,652	103,936
Retained Earnings, July 1, 1998.....	1,893,101	605,047	432,824	2,930,972
Retained Earnings, June 30, 1999.....	\$ 1,917,105	\$ 664,327	\$ 453,476	\$ 3,034,908

NOTE 21.

NO COMMITMENT DEBT

Certain debt of the special purpose authorities, which are discretely presented component units, is issued to finance activities such as construction of new facilities and remodeling of existing facilities, as well as acquisition of equipment. This debt is collateralized solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, the special purpose authorities had \$13.8 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions which involve debt issued by four special purpose trusts that were created by another special purpose authority, called the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges, but which may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, the special purpose trusts had approximately \$5.1 billion of debt outstanding. Similar to the debt of the special purpose authorities, the debt of the special purpose trusts is not a debt of the State.

NOTE 22.**CONTINGENT LIABILITIES****A. Litigation**

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. The following were accrued as a liability in the financial statements: legal proceedings that were decided against the primary government before June 30, 1999; legal proceedings that were in progress as of June 30, 1999, and were settled or decided against the primary government as of November 19, 1999; and legal proceedings having a high probability of resulting in a decision against the primary government as of November 19, 1999, and for which amounts could be estimated. For governmental fund types and expendable trust funds, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made; the remainder is shown as a liability of the General Long-Term Obligations Account Group. For other fund types, the entire liability is recorded in the fund involved. In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may require it to make significant future expenditures or may impair future revenue sources. Because of the prospective nature of these proceedings, no provision for this potential liability has been made in the financial statements.

Following are the more significant lawsuits pending against the primary government:

The primary government is involved in a lawsuit, *Thomas Hayes v. Commission on State Mandates*, related to state-mandated costs. The action involves an appeal by the Director of Finance from a 1984 decision by the State Board of Control now succeeded by the Commission on State Mandates (COSM). The Board of Control decided in favor of local school districts' claims for reimbursement for special education programs for handicapped students. The case was then brought to the trial court by the primary government and later remanded to the COSM for redetermination. The COSM has since expanded the claim to include supplemental claims filed by seven other educational institutions. At its November 30, 1998, final hearing on the mandate question, the Commission held that state

special education requirements exceed the federal mandate in eight components of the special education program. Currently, the Commission is considering adoption of guidelines while the Department of Finance asserts that the claim should be dismissed since existing state funding for special education far exceeds any costs associated with these relatively minor state-mandated components. The parties have announced their agreement to enter into negotiations to explore possible settlement. Accordingly, the Commission has postponed further proceedings for six months to permit negotiations to move forward. The liability to the primary government, if all potentially eligible school districts pursue timely claims, has been estimated by the Department of Finance to be in excess of \$1.5 billion if the State is not credited for its existing funding of the program.

The primary government is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, People of the State of California v. J. B. Stringfellow, Jr., et al.*, the primary government is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. The defendants have filed a counterclaim against the primary government for alleged negligent acts resulting in significant findings of liability against the primary government as owner, operator, and generator of wastes taken to the site. The primary government has appealed the rulings. However, it may request that the court stay the appeal as provided by an Interim Accord. Under this accord, the defendants agreed to waive recovery from the primary government of their past response costs, and the primary government agreed to waive recovery from the defendants of its past costs. In addition, the primary government has agreed to assume responsibility for satisfying the amounts owing to the federal government and for performing all future response actions. This agreement is conditional on the primary government receiving reimbursement from its insurance carriers. Present estimates of the cleanup range from \$455 million to \$655 million.

The primary government is a defendant in two actions, *Cigarettes Cheaper!, et al. v. Board of Equalization, et. al.*, and *California Assn. of Retail Tobacconists, et al. v. Board of Equalization, et. al.*, that challenge the constitutionality of Proposition 10. The plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. The State has filed notice of related cases and contemplates consolidation of the lawsuits. An adverse outcome is possible with a potential refund of \$330 million for past year collections, and future losses of \$750 million each year thereafter.

The primary government is a defendant in two actions, *F. W. Woolworth Co. and Kinney Shoe Corporation v. Franchise Tax Board*, and *Hunt-Wesson, Inc. v. Franchise Tax Board*, that challenge the constitutionality of the interest offset provisions of Revenue and Taxation Code Section 24344(b). In the Woolworth case, the trial

court's judgment favored the Franchise Tax Board. In the Hunt-Wesson case, the trial court's judgment favored the taxpayer. However, this judgement was reversed on appeal. In June 1999, both plaintiffs filed petitions for writ of certiorari in the United States Supreme Court. In August 1999, the Franchise Tax Board filed its opposition to the petitions. On September 28, 1999, the United States Supreme Court granted the petition for writ of certiorari in the Hunt-Wesson case. The granting of certiorari suggests that the court will likely find this tax statute to be unconstitutional. The primary government's potential liability for past collection and interest exposure is \$500 million.

The primary government is a defendant in an action, *Ronald Arnett, et al. v. California Public Employees' Retirement System (PERS); California Board of Administration of PERS; et al.*, that challenges Section 21417 of the Government Code pertaining to industrial disability retirement benefits. The plaintiffs allege that Section 21417 makes retirement decisions based upon age, violating the Age Discrimination in Employment Act of 1967. PERS estimated potential damages of \$316 million (lump sum) in this case and an unfavorable outcome is possible. On November 15, 1999, the primary government filed a writ of certiorari in the United States Supreme Court asking the Court to review the appellate court's ruling that the plaintiffs had stated a claim for age discrimination based upon disparate impact theory.

The primary government is a defendant in a joint action involving fifty-five counties, *Sonoma County, et al., v. Commission on State Mandates*, seeking recovery of property tax revenues reallocated to school districts. The counties contend that this reallocation of revenues constitutes State mandated costs and therefore is subject to reimbursement. On October 18, 1999, the court ruled in favor of the counties. The primary government has announced its intention to appeal. An unfavorable outcome is possible and would require that the State return approximately \$10 billion to the various counties.

The University of California and the special purpose authorities, which are discretely presented component units, are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. The outcome of such matters is either not expected to have a material effect on the financial statements or cannot be estimated at this time.

B. Federal Audit Exceptions

The primary government receives substantial funding from the federal government in the form of grants and contracts. The primary government is entitled to these resources only if it complies with the terms and conditions of the grants and contracts and with the applicable federal laws and regulations; the primary government may spend these resources only for eligible purposes. If audits disclose exceptions, the primary government may incur a liability to the federal government.

NOTE 23.

PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), are included in the primary government. One retirement system, the University of California Retirement System (UCRS), is included in the discretely presented component units. The pension liability for all pension trust funds was determined in accordance with GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers. The amounts of the pension liability for all pension trust funds are presented on Tables 29 and 30 as the net pension obligation (NPO) as of June 30, 1999. Information on the investments of the retirement systems is included in Note 3, Deposits and Investments.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), the Legislators' Retirement Fund (LRF), and the Volunteer Firefighters' Length of Service Award Fund (VFF). CalPERS also administers one defined contribution plan, the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715.

CalPERS uses the accrual basis of accounting. Member contributions are recorded when due except for the VFF and the SPOFF which are funded only by employer contributions. Employer contributions are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due in accordance with the terms of each plan.

The CalSTRS administers two defined benefit retirement plans within the State Teacher's Retirement Fund (STRF). The two plans are the Defined Benefit Program (DB Program) and the Cash Balance Benefit Program (CBB Program). CalSTRS also offers, through a third party administrator, a defined contribution plan that meets the requirements of Internal Revenue Code Section 403(b). CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information on these plans. This report may be obtained from the California State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due and the employer or the primary government has made a formal commitment to provide the

contributions. Benefits are recognized when due and payable in accordance with the retirement program.

**A. Public Employees'
Retirement Fund**

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain special purpose authorities, which are discretely presented component units, 61 school employers, and 1,311 public agencies as of June 30, 1999.

The excess of the actuarial value of assets over the actuarial accrued liability of PERF for the primary government and other participating agencies was \$21.9 billion at June 30, 1998. This is a result of the difference between the actuarial value of assets of \$128.8 billion and the actuarial accrued liability of \$106.9 billion. Contributions are actuarially determined.

**2. Employer's
Information**

Plan Description: The primary government and certain special purpose authorities contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The special purpose authorities' participation in PERF is not a material portion of the program. The primary government has six pension plans within the PERF: first-tier miscellaneous, second-tier miscellaneous, industrial, California Highway Patrol, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 1999, was approximately \$9.8 billion.

All employees who work on a half-time or more basis are eligible to participate in the PERF. The PERF provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five or ten years, depending on the plan. All plans provide death, disability, and survivor benefits. The benefit provisions are established by statute.

Funding policy: Benefits are funded by contributions from members and the primary government and earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. Member rates are defined by law and based on the primary government's benefit formula. The primary government contribution rates are determined by periodic actuarial valuations or by state statute.

Employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$133 to \$863. With the exception of employees in the second-tier plan, employees' required contributions vary from 5.0% to 8.0% of their salary over their base compensation amount.

The required employer contribution rates, without group term life insurance benefits, for the primary government are shown in Table 28. The employer contribution rate for employees in the industrial member category who are covered by group term life insurance is 4.58%. This is 0.02% greater than the rate for employees not covered by group term life insurance.

Table 28

Schedule of Required Employer Contribution Rates for the Primary Government by Member Category

Year Ended June 30, 1999

	Normal Cost	Unfunded Liability	Total Rate
Miscellaneous members			
First tier.....	8.53 %	0.01 %	8.54 %
Second tier.....	6.43	0.01	6.44
Industrial.....	8.90	(4.34)	4.56
California Highway Patrol.....	13.54	0.00	13.54
Peace officers and firefighters.....	14.51	(4.92)	9.59
Other safety members.....	12.10	(2.66)	9.44

For the year ended June 30, 1999, the annual pension cost (APC) and the amount of contributions made by the primary government were each approximately \$829 million. The APC and the percentage of APC contributed for the last three years are shown in Table 29. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 1998, is also shown in Table 29.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, municipal courts, and justice courts appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 1999. The payroll for employees covered by the JRF for the year ended June 30, 1999, was approximately \$139 million. The primary government pays the employer contributions for all employees covered by the JRF.

The JRF provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF provides death, disability, and survivor benefits. Benefits for the JRF are established by the Judges' Retirement Law.

Funding Policy: The required contribution rates of active plan members are based on a percentage of salary over a base compensation amount. For the year ended June 30, 1999, the required contribution rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are not actuarially determined. Contributions are pursuant to state statute.

Employer contributions are required to be 8.0% of applicable member compensation. The other funding to meet benefit payment requirements of the JRF is currently provided from the following sources: filing fees, which require varying amounts depending on fee rate and number of filings; investments, which earn the current yield on short term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are equal to an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year ("pay as you go" basis).

The APC and the amount of contributions made to the JRF for the year ended June 30, 1999, were \$134 million and \$85 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 1999, was \$673 million, an increase of \$50 million over last year's balance of \$623 million. The APC is comprised of \$140 million for the annual required contribution (ARC), \$37 million interest on the NPO, and \$43 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 29. Information on the last valuation, which was performed as of June 30, 1998, is also shown in Table 29. The aggregate cost method that was used for the June 30, 1998, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 29.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts as covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 1999, was approximately \$34 million. The primary government pays the employer contributions for all employees covered by the JRF II.

The JRF II provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF II provides death, disability, and survivor benefits. Benefits for the JRF II are established by the Judges' Retirement System II Law.

Funding policy: The required contribution rate of active plan members is based on a percentage of salary over a base compensation amount. For the year ended June 30, 1999, the required contribution rate for the JRF II was 8.0%. For the year ended June 30, 1999, the primary government's contribution rate for the JRF II was 21.54% of applicable member compensation.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated primary government contribution rate will be adjusted periodically as part of the annual Budget Act in order to maintain or restore the actuarial soundness of the fund.

For the year ended June 30, 1999, the APC and the amount of contributions made for the JRF II were approximately \$7.3 million and \$7.4 million, respectively. The APC and the percentage of APC contributed for the year ended June 30, 1999 are shown in Table 29. Information on the last valuation, which was performed as of June 30, 1998, is also shown in Table 29.

**D. Legislators'
Retirement
Fund**

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for employees covered by the LRF in 1999 was approximately \$3 million.

The LRF provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The plan provides death, disability, and survivor benefits. Benefits for the LRF are established by the Legislators' Retirement Law.

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately four legislative statutory officers.

Funding Policy: The contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. For the year ended June 30, 1999, the actual contributions made by employees were approximately 9.9% of covered payroll. For the year ended June 30, 1999, the primary government's statutory funding rate was 18.81% of covered payroll.

The APC and the amount of contributions made by the primary government to the LRF for the year ended June 30, 1999, were zero and \$0.7 million, respectively. The NPO of the LRF at June 30, 1999, was \$10.7 million, a decrease of \$0.7 million over last year's balance of \$11.4 million. There was no APC because the ARC equaled zero, and the interest on the NPO of \$0.9 million approximated the \$0.9 million adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 29. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 1998, is also shown in

Table 29. The aggregate cost method that was used for the June 30, 1998, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 29.

**E. Volunteer
Firefighters' Length
of Service Award
Fund**

Plan Description: CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There are 47 fire departments participating in the VFF for the year ended June 30, 1999.

The excess of the actuarial value of assets over the actuarial accrued liability of VFF was \$0.2 million at June 30, 1998. This is a result of the difference between actuarial value of assets of \$1.7 million and the actuarial accrued liability of \$1.5 million. Contributions are actuarially determined.

**F. State Peace Officers'
and Firefighters'
Defined Contribution
Plan Fund**

Plan Description: CalPERS administers the SPOFF, which is a defined contribution pension plan. The plan is a qualified money purchase pension plan under Section 401(a) of Title 26 of the United States Code, and is intended to supplement the retirement benefits provided by the PERF to correctional officers employed by the State of California in Bargaining Unit 6.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 1999, contributions by the primary government to the SPOFF were approximately \$16 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to participants will depend only on the amount contributed to participant's account and earnings on the value of the participant's account. Plan provisions are established and may be amended by statute. At June 30, 1999, there were approximately 25,900 participants.

**G. State Teachers'
Retirement Fund**

Plan Description: CalSTRS administers the State Teachers' Retirement Fund (STRF) that includes the Defined Benefit Program (DB Program) and the Cash Balance Benefit Program (CBB Program). These programs are cost-sharing multiple-employer defined benefit retirement plans that provide pension benefits to teachers and certain other employees of the California public school system. Effective January 1, 1999, Senate Bill 2085 authorized the merger of the DB Program and the CBB Program into the STRF.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 1999, the DB Program had approximately 1,160 contributing employers. At June 30, 1998, there were approximately 447,000 plan members and 158,000 benefit recipients. The primary government is a non-employer contributor to the DB Program. The payroll for employees covered by the DB Program in 1999 was approximately \$15.8 billion.

The CBB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full time equivalent for the position. Participation in the CBB Program is optional to employers. However, if the employer elects to offer the CBB Program, each eligible employee will automatically be covered by the CBB Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 1999, the CBB Program had 19 contributing school districts and approximately 6,400 contributing participants. Assets of the CBB Program of \$5 million are combined with the assets of the DB Program in the STRF.

Funding policy: DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Member and employer contributions are a percentage of applicable member earnings. The Teachers' Retirement Law governs member rates, employer contribution rates, and primary government contributions.

DB Program contribution rates of members are 8.0% of applicable member earnings. The employer contribution rate is 8.25% of applicable member earnings. The primary government's contribution to the system, under California Education Code Section 22955, "Elder Full Funding Act," is 4.3% of the previous calendar year's member payroll. Subsequent to achieving a fully funded system, the primary government will contribute only the amount necessary to help fund the normal cost of the current benefit program unless a subsequent unfunded obligation occurs. Beginning July 1, 1999, the primary government shall transfer annually to the DB Program an amount equal to 3.102% of total creditable earnings of the immediately preceding calendar year to fund certain benefit enhancements that became effective January 1, 1999. A statutory contribution rate of 0.307% of payroll under Education Code Section 22952 was eliminated as a separate contribution on October 1, 1998, and incorporated into the rate specified under Section 22955. Beginning October 1, 1998, a statutory contribution rate of 0.524%, adjustable annually in 0.25% increments up to a maximum of 1.505%, of the creditable earnings

of the immediately preceding calendar year under Section 22955 was established. This rate is reduced to zero if there is no unfunded obligation or normal cost deficit. As of the June 30, 1998, actuarial valuation, there was no unfunded obligation or normal cost deficit for benefits in place as of July 1, 1990.

For the year ended June 30, 1999, the APC for the DB Program was approximately \$1.5 billion, and the employer and primary government contributions were approximately \$1.5 billion and \$0.2 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 29. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is also shown in Table 29.

**H. CalSTRS 403(b)
Program**

Plan Description: CalSTRS administers a 403(b) program through a third party administrator. The 403(b) program is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 1999, the 403(b) program had approximately 280 participating employers (school districts) and 1,700 plan members.

Table 29

Actuarial Information – Pension Trusts – Primary Government

June 30, 1999

	Public Employees' Retirement	Judges' Retirement	Judges' Retirement II	Legislators' Retirement	State Teachers' Retirement Defined Benefit Program
Last actuarial valuation.....	June 30, 1998	June 30, 1998	June 30, 1998	June 30, 1998	June 30, 1998
Actuarial cost method.....	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal	Aggregate Cost	Entry Age Normal
Amortization method.....	Level % of Payroll, Closed	None	Level % of Payroll, Closed	None	Level % of Payroll, Open
Remaining amortization period.....	31 years	None	3 years	None	None
Asset valuation method.....	Smoothed Market Value	Market Value	Smoothed Market Value	Smoothed Market Value	Expected Value, 25% Adjustment to Market Value
Actuarial assumption					
Investment rate of return.....	8.25 %	6.00 %	7.75 %	7.50 %	8.00 %
Projected salary increase.....	3.5-17.99	3.75	3.75	3.75	5.50
Includes inflation at.....	3.50	3.50	3.50	3.50	4.50
Post retirement benefit increases.....	2 or 3	3.75	3.00	3.50	2.00
Annual pension costs (In millions)					
Year ended 6/30/97.....	\$ 1,283	\$ 133	\$ 3.0	\$ 1.9	\$ 1,835
Year ended 6/30/98.....	1,178	133	5.4	2.0	1,911
Year ended 6/30/99.....	829	134	7.3	0.0	1,473
Percent contribution					
Year ended 6/30/97.....	124 %	38 %	102 %	130 %	100 %
Year ended 6/30/98.....	100	42	102	34	105
Year ended 6/30/99.....	100	63	101	—	115
Net pension obligation (In millions)					
Year ended 6/30/97.....	\$ —	\$ 546.1	\$ —	\$ 10.1	\$ —
Year ended 6/30/98.....	—	623.0	—	11.4	—
Year ended 6/30/99.....	—	673.0	—	10.7	—
Funding as of last valuation (In millions)					
Actuarial value – assets.....	\$ 52,838	N/A	\$ 15.1	N/A	\$ 77,290
Actuarial accrued liabilities (AAL) – Entry Age.....	46,021	N/A	15.0	N/A	74,234
Excess of actuarial value of assets over AAL (EAV).....	6,817	N/A	0.1	N/A	3,056
Covered payroll.....	9,307	N/A	33.9	N/A	15,741
Funded ratio.....	115 %	N/A	101 %	N/A	104 %
EAV as percent of covered payroll.....	73 %	N/A	0.2 %	N/A	19 %

**I. University of
California Retirement
System - Discretely
Presented Component
Unit**

The UCRS consists of: the University of California Retirement Plan, a single-employer defined benefit plan funded with University and employee contributions; the Public Employees' Retirement System Voluntary Early Retirement Incentive Program (PERS-VERIP), a defined benefit plan for University employees who elected early retirement under the plan; and two defined contribution plans with several investment portfolios funded with employee non-elective and elective contributions. Most University career employees participate in UCRS.

The University of California Retirement Plan provides lifetime retirement income, disability protection, death benefits and pre-retirement survivor benefits to eligible employees of the University of California and its affiliates. Membership in the retirement plan is required for all employees appointed to work at least 50% time for a year or more. Generally, five years of service are required to be entitled to plan benefits. The maximum monthly benefit is 100% of the employee's highest average compensation over a 36-month period. The amount of the pension benefit is determined by salary rate, age, and years of service credit with certain cost-of-living adjustments.

Members' contributions are accounted for separately and accrue interest at 6% annually. Upon termination, members can elect a refund of their contributions plus accumulated interest. Vested terminated members who are eligible to retire can also elect a lump sum payment equal to the present value of their accrued benefits. Both actions thereby forfeit the member's rights to further accrued benefits.

The annually determined rates for employer contributions as a percentage of payroll are based on recommendations of the consulting actuary and appropriations received from the primary government.

Employee contributions may be required to be made to the University of California Retirement Plan. The rate of employee contributions is established annually as a percentage of covered wages, pursuant to the Regents' funding policy, recommended and certified by an enrolled, independent actuary and approved by the Regents, the plan's trustee. During the year ended June 30, 1999, employee contributions to the University of California Retirement Plan were redirected to the University of California Defined Contribution Plan.

There were no changes in actuarial assumptions or benefit provisions that significantly affected the actuarial accrued liability or contribution requirements during the year ended June 30, 1999.

The PERS-VERIP is a defined benefit pension plan providing lifetime supplemental retirement income and survivor benefits to members of the University of California CalPERS program (UC-PERS) who elected early retirement under provisions of the plan. The University contributed to the CalPERS on behalf of these UC-PERS members.

The cost of contributions made to the plan is borne entirely by the University and the federal Department of Energy laboratories. Over the five-year period ended June 30, 1996, the University and the federal Department of Energy laboratories were required to make contributions to the plan as determined by the plan's consulting actuary, sufficient to maintain the promised benefits and the qualified status of the plan.

The University of California maintains two defined contribution plans providing savings incentives and additional retirement security for all eligible University employees. The Defined Contribution Plan (the DC Plan) accepts both after-tax and pretax contributions. In addition, the University has established a Tax Deferred 403(b) Plan (the 403(b) Plan). There are no employer contributions to either of these two plans. Participants in the DC Plan and 403(b) Plan may direct their elective and nonelective contributions to investment funds managed by the Treasurer of the Regents of the University. They may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis.

The DC Plan pretax contributions are fully vested and are mandatory for all employees who are members of the University of California Retirement Plan. Monthly employee contributions range from approximately 2% to 4% of covered wages depending upon whether wages are above or below the Social Security wage base. The 403(b) Plan and the DC Plan after-tax options are generally available to all University employees. During the year ended June 30, participants contributed \$420 million to these two plans.

Table 30

**Actuarial Information – University of California –
Discretely Presented Component Unit**
June 30, 1999

	University of California Retirement Plan	Voluntary Early Retirement Incentive Plan
Last actuarial valuation.....	June 30, 1999	June 30, 1999
Actuarial cost method.....	Entry Age Normal	Unit Credit
Amortization method.....	Level % of Payroll, Open	N/A
Remaining amortization period.....	17.5 years	N/A
Asset valuation method.....	Smoothed Fair Value	Fair Value
Actuarial assumption		
Investment rate of return.....	7.50 %	7.50 %
Projected salary increase.....	4.5 to 6.5	N/A
Includes inflation at.....	4.00	4.00
Annual pension costs (In millions)		
Year ended 6/30/97.....	\$ —	\$ —
Year ended 6/30/98.....	—	—
Year ended 6/30/99.....	—	—
Percent contribution		
Year ended 6/30/97.....	N/A	N/A
Year ended 6/30/98.....	N/A	N/A
Year ended 6/30/99.....	N/A	N/A
Net pension obligation (In millions)		
Year ended 6/30/97.....	\$ —	\$ —
Year ended 6/30/98.....	—	—
Year ended 6/30/99.....	—	—
Funding as of last valuation (In millions)		
Actuarial value – assets.....	\$ 32,087	\$ 82.8
Actuarial accrued liabilities (AAL).....	22,157	43.3
Excess of actuarial value of assets over AAL (EAV)	9,930	39.5
Covered payroll.....	5,347	N/A
Funded ratio.....	145 %	191 %
EAV as percent of covered payroll.....	186 %	N/A

NOTE 24.

POST-RETIREMENT HEALTH CARE BENEFITS

Health care and dental benefits are provided by the primary government and certain special purpose authorities, which are discretely presented component units, to annuitants of retirement systems to which the primary government contributes as an employer. The special purpose authorities' participation in these benefits is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after attaining age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, approximately 100,600 annuitants were enrolled to receive health benefits and approximately 80,100 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the primary government generally pays 100% of the health insurance cost for annuitants plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the primary government generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the primary government's contribution toward dental insurance costs. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30 was approximately \$310 million.

Also, the University of California, a discretely presented component unit, provides certain health plan benefits to retired employees in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. There are approximately 34,000 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30 was approximately \$95 million.

NOTE 25.

SUBSEQUENT EVENTS

The following information represents significant events that occurred subsequent to June 30, 1999, but prior to the date of the auditors' report.

From July 1, 1999, through November 19, 1999, the primary government issued \$1 billion in revenue anticipation notes that will mature on June 30, 2000, \$900 million in general obligation bonds

that were used to retire previously issued commercial paper, and approximately \$238 million in lease revenue bonds.

On August 10, 1999, Standard and Poor's raised its rating on California's General Obligation Bond debt from "A+" to "AA-".

From July 1, 1999, to November 19, 1999, the Regents of the University of California issued approximately \$197 million in revenue bonds and the special purpose authorities, which are discretely presented component units, issued approximately \$508 million in revenue bonds.

In September 1999, legislation was enacted that provided for enhanced benefits for State and school members of the PERF. Benefit enhancements include increased retirement benefits for active State and school members, various one-time cost-of-living adjustments to State and school retirees, and the opportunity for State Second Tier PERF members to elect participation in the First Tier. The future costs for these benefit enhancements is estimated to be \$3.2 billion for State members and \$1.7 billion for school members. As the legislation is not effective until January 1, 2000, the benefit enhancements have not been reflected in the June 30, 1999, required supplementary Schedule of Funding Progress.

On November 19, 1999, the Regents of the University of California, a discretely presented component unit, approved the winding up of the UCSF Stanford Health Care merger and the termination of the various merger agreements. They also authorized the President of the University of California either to dissolve UCSF Stanford Health Care or to use a public benefit corporate structure for the purposes of continuing those activities and services that had been provided by the merged entity.

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STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

December 1999



KATHLEEN CONNELL
California State Controller



KATHLEEN CONNELL
Controller of the State of California

January 7, 2000

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached is the Statement of General Fund Cash Receipts and Disbursements for the period July 1, 1999, through December 31, 1999. This statement reflects the State of California's General Fund cash position and compares actual receipts and disbursements for the 1999-00 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 1999-00 Budget Act. The statement is prepared in compliance with Government Code Section 12461.1, as well as Item 0840-001-0001, Provision 10, of the 1999-00 Budget Act, using records compiled by the State Controller. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's home page at <http://www.sco.ca.gov> under the category Statements of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to William G. Ashby, Chief, Division of Accounting and Reporting, at (916) 327-4144.

Sincerely,

KATHLEEN CONNELL
State Controller

KC:WGA:als

MAILING ADDRESS P.O. Box 942850, Sacramento, CA 94250
SACRAMENTO 300 Capitol Mall, Suite 1850, Sacramento, CA 95814 (916) 445-2636
LOS ANGELES 600 Corporate Pointe, Suite 1150, Culver City, CA 90230 (310) 342-5678

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 1999-00 Budget Act Estimates
(Amounts in thousands)

	July 1 through December 31				
	1999				1998
	Actual	Budget Act Cash Flow Estimate as of Aug 18, 1999	Actual Over or (Under) Estimate		Actual
			Amount (a)	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ 847,936	\$ 847,936	\$ -	-	\$ 934,607
Add Receipts:					
Revenues	29,824,523	27,655,218	2,169,305	7.8	25,598,530
Nonrevenues	211,202	156,909	54,293	34.6	13,904
Total Receipts	30,035,725	27,812,127	2,223,598	8.0	25,612,434
Less Disbursements:					
State Operations	8,385,721	8,754,265	(368,544)	(4.2)	7,958,574
Local Assistance	23,887,767	24,370,828	(483,061)	(2.0)	21,586,327
Capital Outlay	71,976	228,633	(156,657)	(68.5)	61,076
Nongovernmental	344,103	405,819	(61,716)	(15.2)	(266,731)
Total Disbursements	32,689,567	33,759,545	(1,069,978)	(3.2)	29,339,246
Receipts Over / (Under) Disbursements	(2,653,842)	(5,947,418)	3,293,576	-	(3,726,812)
Net Increase / (Decrease) in Temporary Loans	1,805,906	5,099,482	(3,293,576)	(64.6)	2,792,205
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	-
Special Fund for Economic Uncertainties (b)	454,711	-	454,711	-	-
TOTAL CASH	\$ 454,711	\$ -	\$ 454,711	-	\$ -
Borrowable Resources					
Available Borrowable Resources	9,534,506	9,059,752	474,754	5.2	8,972,417
Outstanding Loans	1,805,906	5,099,482	(3,293,576)	(64.6)	2,792,205
Unused Borrowable Resources	7,728,600	3,960,270	3,768,330	95.2	6,180,212

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) May not add to total due to rounding.
- (b) Includes the Disaster Response-Emergency Operations Account within the Special Fund for Economic Uncertainties.
- (c) Excludes State School Building Bonds.
- (d) Negative balances are the result of repayments received that are greater than disbursements made.

SCHEDULE OF CASH RECEIPTS

(Amounts in thousands)

	Month of December		July 1 through December 31				
			1999			1998	
				Budget Act Cash Flow Estimate as of Aug 18, 1999	Actual Over or (Under) Estimate		
	1999	1998	Actual		Amount (a)	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	\$ 25,765	\$ 23,555	\$ 147,173	\$ 142,695	\$ 4,478	3.1	\$ 141,336
Bank and Corporation Tax	958,990	801,118	2,869,479	2,591,536	277,943	10.7	2,577,235
Cigarette Tax	20,887	19,044	70,312	70,741	(429)	(0.6)	77,044
Horse Racing Fees	150	3,783	773	111	662	596.4	12,457
Inheritance, Gift and Estate Taxes	154,155	61,637	506,786	431,861	74,925	17.3	460,436
Insurance Companies Tax	300,601	296,372	621,118	602,540	18,578	3.1	609,777
Personal Income Tax	4,001,520	3,237,647	15,018,011	13,858,065	1,159,946	8.4	12,745,214
Retail Sales and Use Taxes	1,855,748	1,706,084	9,770,633	9,557,801	212,832	2.2	8,586,558
Pooled Money Investment Interest	15,068	26,843	149,755	131,818	17,937	13.6	144,414
Not Otherwise Classified	495,602	31,621	670,483	268,050	402,433	150.1	244,059
Total Revenues	7,828,486	6,207,704	29,824,523	27,655,218	2,169,305	7.8	25,598,530
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	-	-	-	-	-	2,943
Transfers from Other Funds	11,461	(114,018)	82,425	49,619	32,806	66.1	(140,082)
Miscellaneous	9,041	6,952	128,777	107,290	21,487	20.0	151,043
Total Nonrevenues	20,502	(107,066)	211,202	156,909	54,293	34.6	13,904
Total Receipts	\$ 7,848,988	\$ 6,100,638	\$ 30,035,725	\$ 27,812,127	\$ 2,223,598	8.0	\$ 25,612,434

See notes on page 1.

SCHEDULE OF CASH DISBURSEMENTS

(Amounts in thousands)

	Month of December		July 1 through December 31				
			1999				1998
				Budget Act Cash Flow Estimate as of Aug 18, 1999	Actual Over or (Under) Estimate		
STATE OPERATIONS	1999	1998	Actual		Amount (a)	%	Actual
Legislative/Judicial/Executive	77,228	\$ 65,376	\$ 531,396	\$ 533,420	\$ (2,024)	(0.4)	\$ 473,568
State and Consumer Services	26,416	27,733	203,457	205,928	(2,471)	(1.2)	198,264
Business, Transportation and Housing	146	(410)	5,398	4,109	1,289	31.4	6,521
Trade and Commerce	2,648	3,018	17,445	20,113	(2,668)	(13.3)	18,100
Resources	74,197	63,232	425,670	405,085	20,585	5.1	345,587
CA Environmental Protection Agency	15,778	9,641	76,824	87,875	(11,051)	(12.6)	50,234
Health and Welfare:							
Health Services	34,012	33,644	164,929	172,237	(7,308)	(4.2)	169,485
Mental Health Hospitals	41,329	7,235	204,773	216,709	(11,936)	(5.5)	158,754
Other Health and Welfare	42,913	77,968	262,756	253,557	9,199	3.6	228,535
Education:							
University of California	276,747	251,151	1,418,772	1,460,015	(41,243)	(2.8)	1,316,752
State Universities and Colleges	179,546	200,810	1,163,949	1,174,993	(11,044)	(0.9)	1,019,863
Other Education	(1,810)	10,889	82,340	87,312	(4,972)	(5.7)	72,839
Corrections and Youth Authority	209,947	371,048	2,140,367	2,313,663	(173,296)	(7.5)	1,992,254
General Government	67,263	58,602	391,493	560,898	(169,405)	(30.2)	359,882
Public Employees Retirement System	(365)	(44,862)	132,748	67,743	65,005	96.0	414,968
Debt Service (c)	71,866	36,597	1,157,319	1,184,523	(27,204)	(2.3)	1,119,566
Interest on Loans	-	-	6,085	6,085	-	-	13,402
Total State Operations	1,117,861	1,171,672	8,385,721	8,754,265	(368,544)	(4.2)	7,958,574
LOCAL ASSISTANCE							
Public Schools - K-12	1,716,604	1,474,788	10,409,224	10,533,071	(123,847)	(1.2)	9,776,396
Community Colleges	109,638	102,951	1,145,940	1,221,365	(75,425)	(6.2)	1,098,288
Debt Service - State School Building Bonds	-	-	-	-	-	-	-
Contributions to State Teachers' Retirement System	-	-	677,236	677,236	-	-	253,336
Other Education	303,484	136,133	1,059,233	903,073	156,160	17.3	664,059
Corrections and Youth Authority	4,508	5,724	48,707	101,465	(52,758)	(52.0)	62,667
Dept. of Alcohol and Drug Program	22,044	13,039	51,348	51,929	(581)	(1.1)	39,468
Dept. of Health Services:							
Medical Assistance Program	824,324	596,105	4,207,607	4,159,581	48,026	1.2	3,588,567
Other Health Services	41,349	22,732	163,683	166,548	(2,865)	(1.7)	195,889
Dept. of Developmental Services	39,568	114,871	593,728	816,205	(222,477)	(27.3)	597,938
Dept. of Mental Health	(48,530)	199,727	195,692	259,013	(63,321)	(24.4)	230,560
Dept. of Social Services:							
SSI/SSP/IHSS	131,624	178,718	1,508,476	1,546,562	(38,086)	(2.5)	1,055,255
CalWORKs	125,616	74,776	1,705,385	1,826,580	(121,195)	(6.6)	1,937,308
Other Social Services	96,682	92,909	494,886	336,820	158,066	46.9	816,345
Tax Relief	172,409	158,899	299,550	284,347	15,203	5.3	231,540
School Facility Aid Program	-	-	25,736	19,870	5,866	29.5	29,315
Other Local Assistance	213,504	144,618	1,301,336	1,467,163	(165,827)	(11.3)	1,009,396
Total Local Assistance	3,752,824	3,315,990	23,887,767	24,370,828	(483,061)	(2.0)	21,586,327

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)

(Amounts in thousands)

	Month of December		July 1 through December 31				
			1999				1998
	1999	1998	Actual	Budget Act	Actual Over or		Actual
				Cash Flow	(Under) Estimate		
			Estimate as of	Aug 18, 1999	Amount (a)	%	
CAPITAL OUTLAY	12,882	2,893	71,976	228,633	(156,657)	(68.5)	61,076
NONGOVERNMENTAL (d)							
Transfer to Special Fund for							
Economic Uncertainties	-	-	(45)	(45)	-	-	-
Transfer to Other Funds	93,395	26,884	603,216	783,056	(179,840)	(23.0)	123,990
Transfer to Revolving Fund	19,275	115	53,538	21,592	31,946	148.0	61,267
Advance:							
Earthquake Loan Repayment	-	-	-	-	-	-	-
State-County Property Tax							
Administration Program	19,741	15,533	30,733	7,640	23,093	302.3	26,208
Social Welfare Federal Fund	46,492	(154,595)	75,832	33,947	41,885	123.4	(221,675)
Tax Relief and Refund Account	3,100	-	33,200	12,000	21,200	176.7	-
Trial Court Trust Fund	-	-	(187,000)	(187,000)	-	-	(110,000)
Counties for Social Welfare	-	-	(265,371)	(265,371)	-	-	(146,521)
Total Nongovernmental	182,003	(112,063)	344,103	405,819	(61,716)	(15.2)	(266,731)
Total Disbursements	\$ 5,065,570	\$ 4,378,492	\$ 32,689,567	\$ 33,759,545	\$ (1,069,978)	(3.2)	\$ 29,339,246
TEMPORARY LOANS							
Special Fund for Economic							
Uncertainties	\$ (454,713)	\$ (39)	\$ 805,906	\$ 1,255,000	\$ (449,094)	(35.8)	\$ 71,546
Other Internal Sources	(2,328,705)	(1,722,107)	-	2,844,482	(2,844,482)	(100.0)	1,020,659
Revenue Anticipation Notes	-	-	1,000,000	1,000,000	-	-	1,700,000
Net Increase / (Decrease) Loans	\$ (2,783,418)	\$ (1,722,146)	\$ 1,805,906	\$ 5,099,482	\$ (3,293,576)	(64.6)	\$ 2,792,205

See notes on page 1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through December 31			
	General Fund		Special Funds	
	1999	1998	1999	1998
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	\$ 147,173	141,336	\$ -	-
Bank and Corporation Tax	2,869,479	2,577,235	36	7
Cigarette Tax	70,312	77,044	593,352	230,287
Estate Tax	506,582	460,188	-	-
Gift Tax	4	2	-	-
Horse Racing Fees	773	12,457	20,328	25,230
Inheritance Tax	200	246	-	-
Insurance Companies Tax	621,118	609,777	-	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	1,294,063	1,320,702
Diesel & Liquid Petroleum Gas	-	-	230,096	221,521
Jet Fuel Tax	-	-	1,096	966
Vehicle License Fees	-	-	1,682,340	1,958,088
Motor Vehicle Registration and Other Fees	-	-	923,527	858,309
Personal Income Tax	15,018,011	12,745,214	2	172
Retail Sales and Use Taxes	9,770,633	8,586,558	2,029,717	1,884,815
Pooled Money Investment Interest	149,755	144,414	272	178
Total Major Taxes, Licenses, and Investment Income	29,154,040	25,354,471	6,774,829	6,500,275
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	976	1,606	16,360	17,395
Electrical Energy Tax	-	-	109,180	21,996
Private Rail Car Tax	6,568	6,252	-	-
Penalties on Traffic Violations	-	-	37,915	34,360
Health Care Receipts	8,346	9,977	-	-
Revenues from State Lands	11,336	7,660	822	767
Abandoned Property	224,362	105,097	-	-
Trial Court Revenues	747	1,730	-	-
Miscellaneous	418,148	111,737	1,894,232	1,779,283
Not Otherwise Classified	670,483	244,059	2,058,509	1,853,801
Total Revenues, All Governmental Cost Funds	\$ 29,824,523	\$ 25,598,530	\$ 8,833,338	\$ 8,354,076

See notes on page 1.

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APPENDIX B

THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND

This Appendix B includes information about the Department, its Program, the 1943 Fund (including audited financial statements) and the Department's allocation of receipts from Contracts of Purchase, including Excess Revenues.

THE DEPARTMENT

General

In 1921, the California Legislature created the Veterans' Welfare Board and the Program. The Department of Veterans Affairs became the successor to the Veterans' Welfare Board under the Farm and Home Purchase Act of 1943. The Department is a subdivision of the State and constitutes a public corporation. One of the Department's basic objectives is to afford to eligible veterans the opportunity to acquire homes with long-term low-interest financing provided under the Program.

The California Veterans Board ("Board") determines the policies for all operations of the Department. The Board is composed of seven members: the Secretary of Veterans Affairs and six public members appointed by the Governor of the State for respective terms of four years. All of the members of the Board must be veterans, and membership is subject to confirmation by the State Senate. One of these members must be retired from the active or reserve forces of the United States military service. Currently, there is one vacancy on the Board.

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans' Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See "THE PROGRAM."

Administration

In addition to its headquarters in Sacramento, the Division of Farm and Home Purchases maintains field offices located throughout the State. These local offices, in addition to providing information to all veterans concerning the Program, are responsible for Contract of Purchase originations and the initial collection and evaluation of data regarding applicants for the Program and the properties to be acquired under the Program. This includes an examination as to the qualification of veterans to participate in the Program, a credit analysis for each applicant, appraisals of properties and the initial processing of the veterans' applications for Contract of Purchase.

Final processing and servicing of the Contracts of Purchase are performed by the Department at its headquarters and entail Contract of Purchase accounting, insurance and property damage claims adjustment and services, Contract of Purchase alterations and contract performance services. The Department allows Contracts of Purchase origination by mortgage brokers and engaged the temporary services of an outside loan servicing company, Leader Mortgage Company ("Leader"), to service

Contracts of Purchase originated between April 1, 1998 and July 1, 1999. Effective July 1, 1999 the Department began utilizing its new Integrated Loan Processing and Financial Information System for origination and servicing of all new Contracts of Purchase. The servicing contract with Leader expired on February 1, 2000 and all Contracts of Purchase are now serviced by the Department. General administration of the Program, including fiscal, legal, personnel and other administrative functions, is also performed at the Department's headquarters. As of December 31, 1999 the Department's Farm and Home Purchases Division had a staff of approximately 175 persons.

The Secretary and other staff personnel of the Department principally responsible for the administration of the Program are listed below. The Secretary is appointed by the Governor of the State, serves at the pleasure of the Governor and must be a veteran.

Tomas Alvarado
Secretary of Veterans Affairs since May 1999

Secretary Alvarado brings to his position a career-long commitment to veterans issues. Mr. Alvarado has an extensive background in public policy development at every level of government. For the past quarter century he has worked in county government and with the State Legislature and the United States Senate as a member of several public policy staffs. In addition to significant local and legislative experience, Mr. Alvarado has a strong background within the Executive Branch of State government. From January 1999 to May 1999 Mr. Alvarado served as Undersecretary for the Department. In addition, from 1991 to 1995 he served as Deputy Director of Veterans Affairs for then-Governor Wilson. In this position, Mr. Alvarado had as one of his responsibilities oversight of the Program. Mr. Alvarado is a decorated United States Marine veteran of the Vietnam conflict and is a graduate of San Jose State University.

Gerald Rucker
Undersecretary since December 1999

Mr. Rucker brings a 28-year history of California State management to the Department. Recent experience includes eight years as Chief of Veterans Services Division and State Service Officer for the Department. From May 1999 to December 1999 Mr. Rucker served as Senior Assistant to the Secretary of the Department. Prior to joining the Department management team in 1991, he held a variety of management posts with the departments of Social Services and Rehabilitation. These positions included Personnel Management, Loma Prieta Earthquake Disaster Recovery Team manager as well as assignments with fiscal information technology and systems development responsibility. Mr. Rucker is a service-connected disabled veteran who served with the 1st Cavalry Division in Vietnam, including combat action during the TET Offensive of 1968.

Bruce Thiesen
Deputy Secretary for Operations since January 1999

Deputy Secretary Thiesen is a Vietnam-era Army veteran with a long history as a veterans activist. Mr. Thiesen has more than 30 years experience as an independent agribusinessman in farm management, farm labor acquisition and benefits administration. Mr. Thiesen served as National Commander of the American Legion in 1993-1994 and from 1995 through 1998 he was appointed by

the Secretary of the United States Department of Veterans Affairs as a member of the Veterans Advisory Committee on Rehabilitation. In addition to his work on behalf of veterans, Mr. Thiesen is involved in a number of other community and philanthropic efforts.

Sheryl A. Schmidt

Deputy Secretary since November 1996

After leaving the accounting firm of Touche Ross (now known as Deloitte & Touche LLP) in 1987, Deputy Secretary Schmidt began her state career at the State Controller's Office as a Certified Public Accountant (CPA). In 1995, she accepted the newly created position of Chief of Audits at the Department and developed the Internal Audit Division. In 1996, the Governor of California appointed United States Air Force Veteran Sheryl Schmidt as the Deputy Secretary Women Veterans Affairs. Ms. Schmidt holds a Bachelor's degree in management from St. Leo's College in Florida, a Master's of Business Administration (MBA) from California State University Sacramento, and a CPA license from the California State Board of Accountancy.

John M. Hanretty

Deputy, Administration Division since October 1999

Mr. Hanretty is a United States Air Force, Vietnam-era veteran who graduated from California State University, Sacramento in 1975 with a degree in Government. After graduation, he worked for eight years in the California Department of Health Services regulating Prepaid Health Plans for Medicaid clients. He then spent twelve years in management positions with private health maintenance organizations in Arizona and California rising to the level of Chief Executive Officer. His responsibilities included sales, medical management, provider staffing, member services, contracting, financial accounting and budgeting. He returned to State government service in 1994 as a Budget Manager. Mr. Hanretty has served as the Budget Officer for the Department from August 1998 until December 1999 and was appointed Acting Deputy Director of Administration in September 1999. He has continuously served on community non-profit boards of directors during his professional career.

George Flores

Chief, Farm and Home Purchases Division since May 1999

Mr. Flores has been with the Department for 22 years. He has served as Manager of the Title and Escrow Unit, Headquarters Operation Manager, Southern Regional Manager and the Assistant Division Chief. He is a United States Army veteran who was graduated from California State University in 1973 with a Bachelors of Science degree in Business Administration, and he attended the McGeorge School, University of the Pacific.

Kandis L. Mendonsa
Chief, Bond Finance Division since May 1998

Ms. Mendonsa brings to her current position more than a quarter century of service in California state government. For most of that time, she has worked exclusively in the area of financial management. Prior to joining the Department in 1998, Ms. Mendonsa was employed for 10 years by the Department of Social Services and for 12 years at the State Department of Corrections. While at Corrections, among Ms. Mendonsa's responsibilities was the management of a \$4 billion tax exempt bond program for the construction of youth and adult correction facilities.

Arnulfo Hernandez, Jr.
Chief Counsel since June 1999

Mr. Hernandez is an 18-year career employee of the Department. Hired as an entry level attorney, he became the Department's senior trial attorney and was appointed the Chief Counsel of the Department in June 1999. He served as Acting Chief Counsel between March and June 1999. Mr. Hernandez has a Bachelor's Degree in psychology from California State University, Los Angeles and a J.D. from University of the Pacific, McGeorge School of Law, Sacramento and is admitted to practice law in California. Mr. Hernandez is a U.S. Navy veteran, having served his country during the Vietnam war, and was honorably discharged in 1971 with a V.A.-rated, service-connected disability.

Year 2000 Issues

The Department experienced no failures of any systems related to the Program or general Department operations as a result of reaching the year 2000 or the leap year-related milestones. The Department does not expect future expenditures, if any, related to year 2000 compliance to have any negative impact on the Program or the ability of the Department to pay principal and interest on the Revenue Bonds or Veterans G.O. Bonds when due. However, the Department can give no assurance that any such system, internal or external, may not be year 2000 compliant but such non-compliance has yet to be discovered. In its daily operations, the Department uses computer applications developed by outside vendors for the Department and computer software which is widely available commercially. The Department, the developers of its computer systems, the developers of widely available commercial software packages used by the Department and the critical vendors may each subsequently discover areas of non-compliance.

The Depository Trust Company ("DTC") is the registered owner of some of the Veterans G.O. Bonds, and payments of principal and interest on Veterans G.O. Bonds and Revenue Bonds are payable by the Treasurer to DTC, and by DTC to its Participants in those cases. Therefore, timely payment and receipt of principal and purchase price of and interest on the Veterans G.O. Bonds and Revenue Bonds after January 2000 are dependent on the continued successful functioning of DTC's payment system.

Failure by one or more of the Department, the developers of the Department's computer systems, DTC, the developers of the widely available commercial software packages used by the Department and the Department's critical vendors to be in year 2000 compliance could have a materially adverse effect on the programmatic and financial functionings of the Department. In

addition, a subsequently discovered year 2000 noncompliance could give rise to costs to remedy such noncompliance which could have a material negative impact on the Department's operations or financial status. For information regarding the State's Year 2000-related experience, see APPENDIX A – "OVERVIEW OF STATE GOVERNMENT – Year 2000-Related Information Technology".

THE PROGRAM

General

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature (the "Legislature") of the Veterans Farm and Home Purchase Act of 1921. In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 ("1943 Act") which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 ("1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

Since its inception, the Program has assisted over 407,000 veterans to purchase farms and homes throughout the State through long-term housing and farm loans. The sales of revenue bonds and Veterans G.O. Bonds, combined with surplus revenues from borrowers under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs, have financed the purchase of farms and homes since Program inception. As of December 31, 1999 there were 32,208 Contracts of Purchase outstanding with a remaining principal balance of \$2,216,858,116. As of December 31, 1999, the Department has approximately 902 pending applications for Contracts of Purchase in the approximate total principal amount of \$148,000,000. See Exhibit 2 to this APPENDIX B – "Certain Department Financial Information and Operating Data – Contracts of Purchase – Existing Contracts of Purchase" and "– Amounts Expected to be Available to Finance Contracts of Purchase and Related Investments" for information regarding existing Contracts of Purchase and moneys available to finance additional Contracts of Purchase.

The description of the Program under this heading is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof, including recent programmatic changes. The Veterans Code and the Department's implementation thereof are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

Qualifying Veteran Status

Veterans Code. A veteran must meet qualifications established under State law in the Veterans Code in order to participate in the Program. The qualifications specified in the Veterans Code are subject to change by the Legislature. The Veterans Code currently requires, generally, that a veteran must have served at least ninety days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, or as a member of the National Guard or reserves called to active duty by Presidential order, and must have received an honorable discharge or been released from active duty under honorable conditions. The Veterans Code (including amendments effective January 1, 1998) allows the Department to finance Contracts of Purchase for:

(a) veterans who have served during a period which includes service in one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as "Earlier War Veterans");

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period ("Early Vietnam Veterans"); or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are "Vietnam Era Veterans"); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope; or at any time in an expedition or campaign for which a medal was authorized by the United States Government such as the Armed Forces Expeditionary and Vietnam Service Medals (such veterans are referred to as "Recent War Veterans"); and

(b) any person who qualifies under the Federal Tax Code for financing from revenue bonds or unrestricted funds of the Department and who served in the active military, naval, or air service for a period of not less than 90 consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as "Peacetime Veterans").

The amendments to the Veterans Code effective January 1, 1998 added Early Vietnam Veterans and Peacetime Veterans as veterans eligible to receive Contracts of Purchase. The Department expects these amendments to significantly increase the universe of potential contract holders and increase demand for Contracts of Purchase.

Federal Tax Code. In order to determine which Department moneys can be used to finance Contracts of Purchase, the Department must also take into account the requirements of federal law set forth in the Federal Tax Code, which limits the universe of veterans eligible to receive Contracts of Purchase financed from certain sources. See APPENDIX E – "CERTAIN FEDERAL TAX CODE REQUIREMENTS". Applying the current Federal Tax Code separates the Department's lendable moneys into three classes:

(a) "Unrestricted Moneys" (derived from certain moneys in the 1943 Fund and certain proceeds of pre-Ullman (as defined below) revenue bonds and veterans general obligation bonds, including certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code (there are no loan eligibility requirements imposed by the Federal Tax Code with respect to Contracts of Purchase financed by Unrestricted Moneys; these are requirements principally limiting the family income of applicants and the property purchase price, and, subject to certain exceptions, requiring that the veteran not have had a present ownership interest in his principal residence in the three years prior to obtaining such financing ("QMB Loan Eligibility Requirements")). The Department has implemented a policy (which is subject

to change) to make such moneys available for Earlier War Veterans, Vietnam Era Veterans, and Recent War Veterans. ("Pre-Ullman" refers to the period prior to enactment of Federal Tax Code programmatic restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.);

(b) "Qualified Veterans Mortgage Bond Proceeds" (derived exclusively from proceeds of Veterans G.O. Bonds) which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, (ii) served on active duty prior to January 1, 1977, and (iii) was released from active duty fewer than 30 years before receiving such financing. The last date of veteran eligibility under clause (iii) is December 31, 2036 for a veteran with 30 years of continuous service after December 31, 1976. (The QMB Loan Eligibility Requirements do not apply to Contracts of Purchase financed by such moneys.) These proceeds can finance Contracts of Purchase for Earlier War Veterans and Vietnam Era Veterans; and

(c) "Qualified Mortgage Bond Proceeds" (which are principally derived from Revenue Bond proceeds), can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code, and (ii) satisfies the QMB Loan Eligibility Requirements. These proceeds can finance Contracts of Purchase for Earlier War Veterans, Vietnam Era Veterans, Recent War Veterans, and Peacetime Veterans.

Allocation of Lendable Moneys

For those veterans seeking financing who would qualify for Contracts of Purchase from two or more of the above-described financing sources, the Department will select the source of funds to use in its sole discretion. The Department's goal is to maximize the availability of Program benefits. The Board has approved a policy (which is subject to change) to make Qualified Mortgage Bond Proceeds derived from Revenue Bonds the only financing source for Contracts of Purchase for veterans who did not serve during "wartime" (as defined in the Veterans Code).

Administration of the Farm and Home Purchase Program

The Department finances new and existing single-family homes, farms and mobile homes located in the State by acquiring the property selected by a veteran under a Contract of Purchase. The Department also finances home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions of the Federal Tax Code. A Contract of Purchase creates an installment land contract between the Department and the veteran which is somewhat analogous to a loan from the Department to the veteran. The amount which the Department finances is reflected in the Contract of Purchase as the "purchase price."

At present under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed is \$250,000 and for farms is \$300,000 (except that the limitation with respect to certain mobile homes in mobile home parks is \$70,000 and except that the maximum purchase price for any home may be increased by an additional \$5,000 for certain purposes). The Legislature has periodically made changes in the maximum amount that may be financed under a Contract of Purchase. The Federal Tax Code imposes maximum purchase prices on properties which are the subject of Contracts of Purchase financed by Qualified Mortgage Bond Proceeds, which maximums

are adjusted periodically. (No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.) These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area, and whether it is a new or existing home. These Federal Tax Code limits currently range from \$88,266 to \$313,512. The maximum purchase price under the Program is, therefore, the Veterans Code maximum amount or, if the Contract of Purchase is being financed by Qualified Mortgage Bond Proceeds, the lesser of the Veterans Code maximum amount or the maximum amount under applicable provisions of the Federal Tax Code.

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by Qualified Mortgage Bond Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds.

Under amendments to the Veterans Code effective January 1, 1998, any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Contracts of Purchase

General. Pursuant to the Program, the Department and the veteran enter into a Contract of Purchase for a farm, home or mobile home. Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner, but title to the property and improvements is held by the Department as the legal owner until the final principal payment is made. Property sold under a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any permitted encumbrance must be junior or secondary to the Department's interest in the property.

In the past, Contracts of Purchase were not insured or guaranteed by the Federal Housing Administration, the United States Department of Veterans Affairs (the "USDVA"), Rural Development (formerly Farmers' Home Administration), or any private primary mortgage insurer. Now that the Department has been approved by the USDVA as an originator of loans eligible to receive a guaranty from the USDVA, USDVA guaranties are expected to be obtained for most new high loan-to-value ("LTV") Contracts of Purchase. In addition to the USDVA guaranty, the Department has secured primary mortgage insurance for a pool of certain Contracts of Purchase with LTV ratios above 80%, but not to exceed 97%, from Radian Guaranty Inc. ("Radian"), formerly Commonwealth Mortgage Assurance Company ("CMAC"). This insurance retroactively covers, effective February 1, 1998, aggregate losses incurred above a 2% deductible. Veterans and properties which are not USDVA eligible and which do not meet Radian eligibility criteria are expected to continue to be the subject of the Department's Self Insurance Mortgage Loss Set-Aside account (described below). Any change to the foregoing insurance and guaranty expectations could require amending the Department's Program Operating Procedures.

The terms of the Contracts of Purchase are substantially identical regardless of whether they are funded by Unrestricted Moneys, Qualified Veterans Mortgage Bond Proceeds or Qualified Mortgage Bond Proceeds, except for Federal Tax Code-mandated differences in Contracts of Purchase financed with Qualified Mortgage Bond Proceeds. Two ways in which such Contracts of Purchase are different are: (a) Contracts of Purchase financed by Qualified Mortgage Bond Proceeds have more restrictions on the right of a purchaser to assume the obligations under the Contract of Purchase than do Contracts of Purchase financed by Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds; and (b) certain Contracts of Purchase financed by Qualified Mortgage Bond Proceeds are subject to recapture provisions. In addition, the Federal Tax Code contains numerous loan eligibility restrictions on borrowers receiving financing from proceeds such as Qualified Mortgage Bond Proceeds. These restrictions require, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) not have had a present ownership interest in their principal residence during the three-year period preceding the extension of financing, (ii) are eligible to finance the purchase of residences with purchase prices not in excess of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan and (v) may use the proceeds of the financing only to finance one-family or one-to-four family dwelling units meeting certain criteria. The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy these requirements but requires that 95% or more of the proceeds of the issue be used in full compliance with the loan eligibility restrictions.

Since the number and value of Contracts of Purchase relating to farms and mobile homes, and Contracts of Purchase financed pursuant to the 1943 Act are statistically insignificant, the discussion below is limited to Contracts of Purchase financed under the 1974 Act for homes, excluding farms and mobile homes in rental parks, unless otherwise indicated. See Exhibit 2 to this APPENDIX B – "Certain Department Financial Information and Operating Data – Contracts of Purchase – Existing Contracts of Purchase."

Origination. The Veterans Code, in most cases, requires the veteran to make an initial payment of 2% of either the purchase price or the market value of the property, whichever is less. In the case of veterans who are ineligible for a full USDVA guaranty, Department policy now requires the veteran to make an initial payment of 3% of either the sales price or the market value of the property, whichever is less. The balance of the purchase price, including USDVA guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days for all Contracts of Purchase guaranteed by USDVA, and 40 years for any other Contracts of Purchase. Department policy is to issue all new Contracts of Purchase for terms of 30 years. Existing contracts are occasionally extended beyond 30 years in cases of extreme financial hardship.

A Loan Origination Fee ("LOF") of 1% is collected at close of escrow on all contracts issued after January 1, 1999. This fee must be paid in escrow by the buyer or seller. If the loan application is submitted through an approved mortgage broker, the 1% fee is paid directly to the broker through the escrow. Otherwise, the fee is retained by the Department. While the Department's field offices will continue to originate Contracts of Purchase, the Department expects the bulk of the Contracts of Purchase to be originated by mortgage loan brokers in the future. The brokers will deal directly with the central underwriting, escrow and administrative staff in Sacramento, not through the Department's field offices. An appraisal fee of \$300 to \$425 is collected from the applicant and is paid directly to the

appraiser upon completion of the assignment. In rare cases, where the appraisal is performed by a Department employee, the fee is retained by the Department.

The Veterans Code permits the Department to finance permanent home and property improvements for veterans with existing Contracts of Purchase. Total financing, including the balance of the original loan, the amount of the improvement loan, and any other encumbrances, cannot exceed 90% of the improved market value of the property. Typically this total LTV ratio is much lower than 90%. Improvement loans are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application. Funds are disbursed by the Department directly to the contractors (or vendors) as the improvements are completed. A separate Contract of Purchase is executed which bears interest at the same rate as the existing contract. The new Contract of Purchase is payable over a term up to 15 years based on the amount of the Contract of Purchase. In no event can the term, from the inception of the original Contract of Purchase through the pay-off of the improvement Contract of Purchase, exceed 40 years. A LOF of 1.5% of the improvement Contract of Purchase amount is charged. The maximum home improvement loan for veterans funded with Qualified Mortgage Bond Proceeds is \$15,000 over the term of the original Contract of Purchase. Home improvement loans funded with Unrestricted Moneys or Qualified Veterans Mortgage Bond Proceeds are available up to a maximum of \$50,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available, so long as there is only one home improvement Contract of Purchase to any veteran outstanding at any time. Currently, less than one percent of the total principal balance of all Contracts of Purchase is derived from home improvement loans.

Contracts of Purchase for the purchase of a building site and construction of a home are available. Qualifying sites include undeveloped sites/acreage, lots in subdivision developments, and sites in non-profit self help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a licensed California contractor. The Department does not submit Contracts of Purchase which finance home construction for USDVA guaranty during the construction phase. Procedures are being developed to obtain guaranties on the properties once construction is completed.

The Department also limits availability of financing to veterans on the basis of their personal credit status. The Department's current lending criteria conform to those of the USDVA for participation in the USDVA guaranty program for all Contracts of Purchase, including those not eligible for USDVA guarantees. Department procedures are consistent with those established by USDVA for its loan guaranty program.

The history of the Department's originations of Contracts of Purchase, is set forth in Exhibit 2 to this APPENDIX B - "Certain Department Financial Information and Operating Data Contracts of Purchase Contracts of Purchase Origination and Principal Repayment Experience."

Servicing. Prior to January 2000, only Contracts of Purchase originated prior to April 1, 1998 or on or after July 1, 1999 were serviced by the Department utilizing the Department's new Integrated Loan Processing and Financial Information System which became operational on July 1, 1999. All Contracts of Purchase originated between April 1, 1998 and July 1, 1999 were serviced under a contract with Leader Mortgage Company ("Leader"). In January 2000, the Department added the

Contracts of Purchase serviced by Leader into the new information system. As a result, all Contracts of Purchase are now being serviced by the Department.

Late penalty charges are applied to Contracts of Purchase that have a remaining amount due of \$25 or more at the close of any account month. A \$10 late penalty charge is imposed on Contracts of Purchase originated before October 1984. Contracts of Purchase originated during and after October 1984 are subject to a late penalty charge of 4% of the principal and interest portion of the installment, consistent with penalties authorized by USDVA.

The Department may, in any individual case and for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment. Contracts of Purchase may also have terms in excess of 30 years if home improvement loans have been obtained, as discussed above. The terms of Contracts of Purchase guaranteed by USDVA, however, cannot exceed 30 years and 32 days.

Prepayment Penalties. There are no prepayment penalties on any Contracts of Purchase.

Cancellations and Delinquencies. The Department's policies regarding delinquencies and cancellations conform to USDVA loan guaranty program requirements. In the event of a failure to comply with any of the terms of a Contract of Purchase, the Department may cancel the Contract of Purchase and be released from all obligations, at law or in equity, to convey the property. In such event, the veteran's rights under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase deemed to be rental paid for occupancy. Upon such forfeiture, the Department takes possession of the property covered by the Contract of Purchase and resells it.

If a veteran does not make a payment by the close of the account month in which the payment is due (usually the 18th day of the month), the payment is considered "delinquent." A warning letter is issued on the 20th day of the same account month which advises the veteran that the account is delinquent. Department personnel initiate telephone contact with veterans with delinquent accounts. If the account remains delinquent through the second account month, a Notice of Intent to Cancel Contract is issued at the beginning of the third account month giving notice that the Contract of Purchase may be canceled at the end of the 30-day notice period unless the account is brought current. A schedule for liquidation of delinquent payments satisfactory to the Department is arranged during this period; *however*, if the account remains delinquent after such 30-day period and no schedule for liquidation of delinquent payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. The Department's headquarters Central Collections Unit monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and forwards the pertinent information to the Department's Foreclosure Unit for further precancellation processing in accordance with the California Code of Regulations, Title 12, Section 344, Military and Veterans Affairs. Junior lienholders are identified and sent notices giving them 30 days (40 days in the case of federal tax liens) to protect their interest by beginning foreclosure proceedings. If the account is not brought current during such notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department's Foreclosure Unit cancels the contract, and a Notice of Cancellation is mailed to the veteran and recorded. The Department's Foreclosure Unit

then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department's Law Division for additional processing.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary, and is marketed through the Department's centralized repossession sales unit. The Department is required to advertise and accept sealed offers after a 2-week period, and the property is sold to the highest acceptable bidder. If no acceptable bids are received, the property is sold through a real estate broker and a commission of between 3% to 6% of the selling price is paid.

Federal law provides certain protections to military personnel on active duty or reservists ordered to report for military service under The Soldiers' and Sailors' Civil Relief Act of 1940, as amended. If a veteran obtained a Contract of Purchase prior to the relevant period of military service, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the veteran to pay interest in excess of 6% is not materially impaired by such military service). Also, the veteran may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding.

See Exhibit 2 to this APPENDIX B – "Certain Department Financial Information and Operating Data – Cancellations and Delinquencies" for additional information regarding the status of Contracts of Purchase.

Interest Rates. Contracts of Purchase originated prior to January 1, 1999 bear interest at a rate which is set by the Department and may be changed with the approval of the Board and the Veterans' Finance Committee of 1943. Most of such Contracts of Purchase currently bear interest at a rate of 6.95%. The Veterans Code currently requires that, generally, all Contracts of Purchase originated prior to January 1, 1999 bear the same interest rate. In accordance with the current provisions of the Veterans Code, the interest rate for such Contracts of Purchase can be changed at any time and as often as necessary. The effective date of a higher rate of interest on Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Veterans' Finance Committee of 1943 that such additional action is necessary to protect the solvency of the 1943 Fund.

Legislation passed in 1998 (i) eliminated the uniform interest rates requirement for Contracts of Purchase originated on or after January 1, 1999 and (ii) allows the Department to establish non-uniform fixed or variable interest rates for such Contracts of Purchase. The current interest rates for such Contracts of Purchase are: 5.95% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, and 6.65% for all other loans.

Loan Insurance

The Department has completed several programmatic changes, including obtaining loan insurance from private primary mortgage insurers for certain new and existing Contracts of Purchase with high LTVs and USDVA guaranties for most new Contracts of Purchase with high LTVs. The Department collects a funding fee of from 1.25% up to 3% of the Contract of Purchase amount, based on the LTV for all Contracts of Purchase which exceed an LTV of 80%. With respect to eligible Contracts of Purchase, this fee is paid to the USDVA for the cost of the loan guaranty. The fee may be paid in escrow by the buyer or seller, or it may be added to the base loan amount. Veterans described above who are ineligible for a full USDVA guaranty and therefore are obligated to make an initial 3% payment must advance a funding fee of up to 2% of the base loan amount to the Department at close of escrow, and the funding fee may not be added to the base loan amount. If the veteran or the property is not eligible for a USDVA loan guaranty, the funding fee is placed in the Self Insurance Mortgage Loss Set-Aside Account. A portion of the fee is used to purchase primary mortgage insurance. Any change to the foregoing insurance and guaranty expectations could require amending the Department's Program Operating Procedures.

Primary Mortgage Insurance. The Department has purchased primary mortgage insurance for a pool of certain Contracts of Purchase with LTVs above 80% but not to exceed 97%. This insurance is being provided through a contract with Radian. The Radian policy provides coverage back to February 1, 1998, for aggregate losses incurred on Contracts of Purchase in the pool, following property disposition, above an aggregate 2% deductible based upon a percentage of originally insured balances. Under the Radian policy, once the aggregate deductible has been reached, insurance claims may be made based upon the individual LTV of the particular defaulted Contract of Purchase, as set forth below. For these purposes, LTV is calculated using the original appraised value of the property.

Radian Mortgage Insurance Coverage Rates Subject to a Deductible of 2% of the Total Original Dollar Amount of the Insured Pool

<u>LTV Category</u>	<u>% of Coverage</u>
95.01% to 97.00%	35%
90.01% to 95.00%	30%
85.01% to 90.00%	25%
80.01% to 85.00%	17%

The Department intends to include Contracts of Purchase with 80.01% to 97% LTV ratios that are not qualified for USDVA guaranties (except mobile homes in parks, construction loans and home improvement loans all of which are covered by the Department) in the 2% aggregate loss primary mortgage insurance contract with Radian unless and until the aggregate principal amount of Contracts of Purchase so insured by Radian exceeds the coverage amount of the insurance contract. As of December 31, 1999, the remaining available coverage amount under such Radian contract was approximately \$145,000,000, although Contracts of Purchase in an aggregate original principal amount of \$59,522,066 are currently in process for coverage under the Radian policy. The Department expects that if the remaining coverage amounts under the Radian contract are exhausted, the Department will attempt to obtain a similar contract, to the extent feasible and at a reasonable cost. See Exhibit 2 to this APPENDIX B – "Certain Department Financial Information and Operating Data – Contracts of

Purchase – Existing Contracts of Purchase" and "– Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

USDVA Guaranty Program. The Department has been approved by the USDVA as a "supervised lender with automatic processing authority" as of March 10, 1998. On July 27, 1998, the Department received USDVA approval under the Lender Appraisal Processing Program ("LAPP") to process appraisals and determine reasonable value without prior USDVA review. The Department seeks USDVA loan guaranties for all Contracts of Purchase with an LTV ratio of 80% or higher, unless the Contract of Purchase is not eligible for USDVA guaranty. Contracts of Purchase not eligible for guaranty are primarily contracts with veterans who have previously used their USDVA guaranty eligibility and do not qualify for reinstatement, and contract for the purchase of new homes not inspected by USDVA during construction. A very small number of veterans have service that meets Veterans Code eligibility requirements but does not meet USDVA eligibility requirements.

The Servicemen's Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran's spouse) to obtain a mortgage loan guaranty from USDVA covering mortgage financing of the purchase or construction of a one-to-four family dwelling unit at interest rates permitted by USDVA. The USDVA program has no preset mortgage loan limits and permits the guaranty of mortgage loans of up to 30 years and 32 days' duration. Under the USDVA program, the maximum USDVA guaranty on a loan is the lesser of (a) the veteran's available entitlement (a maximum of \$36,000, or if the original loan amount exceeds \$144,000, a maximum of \$50,750), or (b) (1) 50% of the original loan amount if such amount does not exceed \$45,000, (2) \$22,500 if the original loan amount is between \$45,000 and \$56,250, (3) the lesser of \$36,000 or 40% of the original loan amount, if such amount is between \$56,250 and \$144,000, or (4) the lesser of \$50,750 or 25% of the original loan amount, if such amount is in excess of \$144,000. The liability on the guaranty is reduced or increased pro rata with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the guaranty exceed the amount of the original guaranty. Notwithstanding the dollar and per centum limitations of the guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original guaranty as adjusted. Extended periods without interest payments prior to foreclosure will also increase the potential for losses. In the event of a default in the payment of a USDVA loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to a mortgage holder the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and security.

Self Insurance Mortgage Loss Set-Aside. The Department has established a mortgage loss account within the 1943 Fund to be funded by mortgage insurance charges (funding fees) paid by veteran recipients of Contracts of Purchase that do not qualify for USDVA guarantees and high LTV Contracts of Purchase that are not insured under the Radian policy.

Property and Life and Disability Insurance

The Veterans Code and/or long-standing Department policy have called for a veteran to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department, and is either provided by

the Department or by insurance companies selected by the Department. Any change to the insurance requirements could require amending the Department's Program Operating Procedures.

Fire and Hazard Coverage. The Department self-insures for fire and hazard losses, using the 1943 Fund to make payments to veterans, up to a Department deductible. The Master Policy described below (the "Master Policy") provides coverage in excess of the Department deductible, except that the Master Policy does not cover mobile homes, condominiums or planned unit development properties covered by blanket insurance policies provided by homeowners' associations. The Master Policy is provided by commercial insurers. The lead insurance company is Affiliated F.M. Insurance Company.

Under each Contract of Purchase, the veteran is required to pay the sum charged to his or her account to cover costs of providing the insurance coverage including the insurance premium due under the Master Policy described below with respect to his or her property. From the amount charged to each veteran, the Department retains a portion to provide the sums necessary to pay all losses up to the Department deductible, which is \$1,250,000 per occurrence or \$10,000,000 per policy year. If the total losses from a single occurrence exceed \$1,250,000 or if the aggregate of all fire and hazard insurance losses for a policy year exceed \$10,000,000 liability for the excess will be covered under the Master Policy. The coverage under the Master Policy extends to October 31, 2000. The Master Policy is an all-physical loss form.

Fire and hazard insurance coverage for participants in the Program is adjusted annually to reflect increasing building costs and is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A \$250 deductible payable by the veteran applies to each loss. Claims must be submitted within 12 months of loss. Each veteran with a Contract of Purchase pays an annual insurance premium equal to \$0.22 per \$100 of insured value which is prorated and included in the veteran's monthly installment. Claims adjustments and payments are made on behalf of the Department and the provider of the Master Policy by an affiliate of such provider.

Disaster Indemnity Plan. The Department provides certain disaster indemnity and catastrophe real property insurance ("Disaster Indemnity Plan"). Neither such insurance nor the indemnity fund described below are payable from or a part of the 1943 Fund. The Disaster Indemnity Plan indemnifies participants against the cost of repairing damage in excess of a deductible caused by flood, earthquake or other perils not covered by the fire and hazard insurance policy (not otherwise excluded). The deductible for flood losses is \$500 and the deductible for earthquake losses is \$500 or 5% of the amount of loss, whichever is higher. The catastrophe insurance has been obtained from a consortium of twelve insurance companies for a total of \$50,000,000 of coverage with a \$4,000,000 deductible per occurrence and in the aggregate annually; \$100,000 per occurrence maintenance deductible thereafter. The 1999 to 2001 two-year premium for this coverage is \$5,100,000.

Each veteran in the Program participates in the Disaster Indemnity Plan and pays his or her pro rata share of the annual premium. Such payments are deposited in an indemnity fund created in the Treasury of the State to be utilized to pay the deductible discussed above. Each veteran pays an initial assessment of \$1.35 per \$1,000 of insured value, and any assessments as may be required to sustain the indemnity fund. The value of the indemnity fund as of June 30, 1999 was \$14,849,384.

Effective December 1, 1997, the Department has purchased individual flood policies through the Federal Emergency Management Agency ("FEMA") covering all properties financed by Contracts of Purchase that are located in designated flood zones. Coverage under this policy extends to December 1, 2001.

Life and Disability Coverage. In the past, the Department self-insured from the 1943 Fund life and disability coverage for veterans with Contracts of Purchase. Following a period of significant and recurring losses incurred by the 1943 Fund (see "THE 1943 FUND—Selected Financial Data of the 1943 Fund and Department's Discussion" in this APPENDIX B), the Department, effective June 1, 1996, replaced most of the Department's self-insured life and disability insurance program with an interim life and disability insurance plan (the "Life and Disability Plan") provided by Pacific Life and Annuity Company ("Pacific Life") (previously PM Group Life Insurance Company). Effective February 1, 1998, the interim plan after a competitive bidding process was replaced by a replacement, long-term life insurance and disability plan, also provided by Pacific Life. The Department continues to self-insure those veterans who were already receiving disability benefits at the time the Life and Disability Plan was implemented. Benefits are equal to the amount of the monthly Contract of Purchase payment at the time of their disability. Those benefits will continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or his or her contract is paid off. Loss reserves for these obligations are actuarially based. A portion of the required loss reserves is maintained under a third-party administrator agreement and is shown in the financial statements for the 1943 Fund as investments with insurance administrators. The remaining amount is unfunded, but reserved in the form of a loss against retained earnings. See "THE 1943 FUND – Selected Financial Data of the 1943 Fund and Department's Discussion" in this APPENDIX B.

Effective February 1, 1998, the Department implemented a new life and disability protection plan which is provided by Pacific Life. All holders of Contracts of Purchase who had life and disability coverage (exclusive of those receiving benefits as described in the preceding paragraph) under the prior plan were transferred automatically to the new plan. Major elements of the life and disability coverage will continue unchanged for all currently insured Contract of Purchase holders up to age 60. For formerly insured holders of Contracts of Purchase under age 60, 100% of the loan balance is covered. Life insurance coverages at subsidized rates for those currently insured Contract of Purchase holders in the program over age 60 are limited to a maximum of the loan amount or \$75,000, if less, reducing in increments every 5 years to a maximum of \$5,000 after age 80. Such Contract of Purchase holders can obtain, at commercial insurers' rates, full coverage. Holders of new Contracts of Purchase after February 1, 1998 are covered under a revised insurance plan. The Department continues to require life insurance coverage but in an amount sufficient to cover home payments for five, three or one year(s) depending on the health of the individual loan applicant. All new Contract of Purchase applicants must apply and must be provided the minimum life insurance coverage. Disability coverage for a period up to two years is optional for new Contract of Purchase holders after February 1, 1998, but is a mandatory requirement for Contract of Purchase holders with Contracts of Purchase in existence prior to February 1, 1998. The disability insurance benefit provides home loan protection by paying the participant's monthly loan installment (including insurance premiums) for a maximum benefit period of two years per disability, unless due to a psychiatric condition which would then limit the maximum benefit period to 12 months. Additional, full coverage, life insurance may also be purchased as an option by new Contract of Purchase holders. Spouse life insurance coverage is available as an option. The new plan is an experience rate plan subject to annual rating reviews of

insurance claims, expenses, risk charges, profits and premiums. In addition to the new insurance coverages, the Department has established a one-time \$5 million rate stabilization reserve, which the Department will retain with interest as part of the 1943 Fund.

THE 1943 FUND

General

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to canceled Contracts of Purchase, (iv) temporary investments, cash and funds, and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, the Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing of debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department, and to fund certain losses from and reserves for property insurance and life and disability insurance described above in this APPENDIX B under "THE PROGRAM – Property and Life and Disability Insurance."

While the 1998 Financial Statement for the 1943 Fund reflected an increase in retained earnings, the Department's 1999 Financial Statement for the 1943 Fund reflects a loss in retained earnings. In addition, the Program has experienced significant losses during other recent fiscal years in the retained earnings in the 1943 Fund. For additional information, see below "Selected Financial Data of the 1943 Fund and Department's Discussion" and also see Exhibit 1 to this APPENDIX B – "Financial Statements of the 1943 Fund for Fiscal Years 1999 and 1998 and Independent Auditor's Report."

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds. Moneys in the 1943 Fund must be paid, on the debt service payment dates of Veterans G.O. Bonds, to the General Fund in the amount of the principal of (whether at maturity or upon redemption or acceleration), and premium and interest on Veterans G.O. Bonds then due and payable (other than debt service payable from the proceeds of refunding bonds). Debt service on Veterans G.O. Bonds is payable from the General Fund, even if the amount transferred from the 1943 Fund to the General Fund is less than such debt service amount. The balance remaining unpaid must be transferred to the General Fund out of the 1943 Fund as soon thereafter as it becomes available, together with interest thereon at the rate borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are repaid to the General Fund, no payments may be made on the Revenue Bonds other than from amounts then in the Bond Reserve Account and the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds.

As of December 31, 1999, there were outstanding \$2,636,235,000 aggregate principal amount of Veterans G.O. Bonds and \$395,655,000 aggregate principal amount of Revenue Bonds. As of December 31, 1999, \$176,835,000 of new issue Veterans G.O. Bonds are authorized but not issued, and the Department may in the future seek voter approval for additional amounts of Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will not use any portion of such \$176,835,000 authorization. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed \$1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. See "THE OFFERED VETERANS G.O. BONDS – PURPOSE" for information about the issuance of Veterans Revenue Bonds during the first six months of year 2000. Additional information about outstanding Veterans G.O. Bonds and Revenue Bonds is in Exhibit 2 to this APPENDIX B – "Certain Department Financial Information and Operating Data – Veterans G.O. Bonds and Revenue Bonds."

See "1943 FUND-External Reviews of the Program" in this APPENDIX B for a discussion of suggestions that moneys in the 1943 Fund be applied to finance benefits for veterans outside the Program.

For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see "THE PROGRAM—Contracts of Purchase" in this APPENDIX B and Exhibit 2 to this APPENDIX B—"Certain Department Financial Information and Operating Data—Contracts of Purchase."

Selected Financial Data of the 1943 Fund and Department's Discussion

Selected Financial Data of the 1943 Fund

The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1999 and 1998 has been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in Exhibit 1 to APPENDIX B in this Official Statement. The following selected financial data of the 1943 Fund for fiscal years ended June 30, 1997, 1996 and 1995 has also been derived from the audited financial statements of the 1943 Fund which are not included herein. This selected financial data should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said Exhibit 1 and the Department's Discussion of Financial Data contained herein.

Beginning with the fiscal year ended June 30, 1998, the financial statements of the 1943 Fund are required to reflect accounting changes required by promulgation of Statement No. 31 by the Governmental Accounting Standards Board ("GASB 31"). GASB 31 requires all investments to be reported at their fair market value (rather than book value) and investment income to be adjusted to reflect the difference between the fair market and book value of investments as either a capital gain or loss. The financial data derived from the financial statements of the 1943 Fund for FY 1995 through FY 1997 and presented in the tables below have been adjusted to reflect the impact of GASB 31 on investments and investment income so as to make such data consistent with the accounting procedures used in preparing the FY 1998 and FY 1999 financial statements.

The impact of GASB 31 adjustments over the five-year period reflected in the tables below (including FY 1999) are a cumulative decrease of \$2,983,000 in the deficiency of revenues over expenses and cumulative increase of the same amount in retained earnings.

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SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>	<u>Restated June 30, 1996</u>	<u>Restated June 30, 1995</u>
ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:					
CASH AND INVESTMENTS					
Cash and amounts on Deposit in SMIF	\$239,979	\$325,321	\$317,178	\$295,140	\$306,269
Guaranteed Investment Contracts	890,692	938,888	365,542	475,744	591,449
Treasury Securities	<u>183,645</u>	<u>187,851</u>	<u>347,214</u>	<u>363,426</u>	<u>395,113</u>
Total	1,314,316	1,452,060	1,029,934	1,134,310	1,292,831
DUE FROM VETERANS DEBENTURE REVENUE FUND					
	22,471	12,686	86,279	137,141	137,166
OTHER CURRENT ASSETS	18,335	13,755	22,596	26,191	25,787
NET OTHER NON-CURRENT ASSETS	33,262	36,406	15,123	15,824	16,600
CONTRACTS OF PURCHASE					
Performing Contracts	2,040,587	2,035,879	2,154,142	2,231,994	2,356,818
Non Performing Contracts	<u>28,669</u>	<u>62,872</u>	<u>75,038</u>	<u>74,268</u>	<u>53,257</u>
Total	2,069,256	2,098,751	2,229,180	2,306,262	2,410,075
Allowance For Contract Losses	(21,263)	(22,005)	(26,412)	(15,801)	(15,066)
Reduction of REO to Fair Value	<u>(8,104)</u>	<u>(19,003)</u>	<u>(24,003)</u>	<u>(17,113)</u>	<u>(12,334)</u>
Total	<u>(29,367)</u>	<u>(41,008)</u>	<u>(50,415)</u>	<u>(32,914)</u>	<u>(27,400)</u>
BONDS PAYABLE					
General Obligation Bonds	(2,687,390)	(2,947,165)	(2,632,045)	(2,812,810)	(3,002,695)
Revenue Bonds	<u>(404,215)</u>	<u>(275,055)</u>	<u>(327,580)</u>	<u>(374,975)</u>	<u>(434,545)</u>
Total	<u>(3,091,605)</u>	<u>(3,222,220)</u>	<u>(2,959,625)</u>	<u>(3,187,785)</u>	<u>(3,437,240)</u>
OTHER CURRENT LIABILITIES	<u>(56,369)</u>	<u>(58,458)</u>	<u>(80,502)</u>	<u>(86,716)</u>	<u>(90,868)</u>
Net Lending & Financing Activities					
Assets	<u><u>280,299</u></u>	<u><u>291,972</u></u>	<u><u>292,570</u></u>	<u><u>312,313</u></u>	<u><u>326,951</u></u>
ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:					
LIFE AND DISABILITY COVERAGE					
Deposits with Insurance Administrators	30,573	40,823	48,762	56,843	65,246
Insurance Reserves and Claims Payable	<u>(39,751)</u>	<u>(53,185)</u>	<u>(65,828)</u>	<u>(78,246)</u>	<u>(79,729)</u>
Total	(9,178)	(12,362)	(17,066)	(21,403)	(14,483)
FIRE AND HAZARD COVERAGE					
Net Insurance Reserves and Claims Payable	<u>(1,552)</u>	<u>(1,209)</u>	<u>(1,405)</u>	<u>(2,744)</u>	<u>(5,013)</u>
Net Insurance Activities Liabilities	<u><u>(10,730)</u></u>	<u><u>(13,571)</u></u>	<u><u>(18,471)</u></u>	<u><u>(24,147)</u></u>	<u><u>(19,496)</u></u>
RETAINED EARNINGS	<u><u>\$ 269,569</u></u>	<u><u>\$ 278,401</u></u>	<u><u>\$ 274,099</u></u>	<u><u>\$ 288,166</u></u>	<u><u>\$ 307,455</u></u>
SUMMARY INFORMATION					
Total Assets	\$3,435,000	\$3,587,000	\$3,377,000	\$3,639,000	\$3,916,000
Total Liabilities	\$3,159,000	\$3,309,000	\$3,103,000	\$3,351,000	\$3,609,000
Total Number of Contracts of Purchase	32,243	35,906	39,343	42,650	47,075

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	<u>June 30, 1999</u>	<u>June 30, 1998</u>	<u>Restated June 30, 1997</u>	<u>Restated June 30, 1996</u>	<u>Restated June 30, 1995</u>
NET INCOME FROM LENDING AND FINANCING ACTIVITIES:					
INTEREST INCOME					
Interest on Contracts	\$139,839	\$162,086	\$175,186	\$182,636	\$181,595
Interest on Investments	75,292	74,077	67,373	79,510	76,846
Transfer of Interest From Veterans Debenture Revenue Fund	887	3,317	10,843	11,144	11,164
Total	<u>216,018</u>	<u>239,480</u>	<u>253,402</u>	<u>273,290</u>	<u>269,605</u>
BOND INTEREST EXPENSE	<u>(201,772)</u>	<u>(218,757)</u>	<u>(230,871)</u>	<u>(245,971)</u>	<u>(252,792)</u>
Net Interest Income (Expense)	<u>14,246</u>	<u>20,723</u>	<u>22,531</u>	<u>27,319</u>	<u>16,813</u>
GASB 31 ADJUSTMENT	<u>(6,897)</u>	<u>(4,578)</u>	<u>8,420</u>	<u>(12,580)</u>	<u>18,618</u>
GAIN ON SALE OF SECURITIES	2,351	13,460			
RESTRUCTURING EXPENSES	<u>(6,342)</u>	<u>(3,068)</u>			
	<u>(10,888)</u>	<u>5,814</u>	<u>8,420</u>	<u>(12,580)</u>	<u>18,618</u>
CONTRACTS OF PURCHASE					
PMI	(2,330)	(1,551)			
Net loss on Sale of REO'S	(3,886)	(3,128)	(8,309)	(5,510)	(2,200)
Increase in Allowance for Contract Losses	<u>3,343</u>	<u>(1,312)</u>	<u>(22,677)</u>	<u>(5,515)</u>	<u>(10,463)</u>
Total	<u>(2,873)</u>	<u>(5,991)</u>	<u>(30,986)</u>	<u>(11,025)</u>	<u>(12,663)</u>
Net Lending/Financing Activities Income (Expense)	<u>485</u>	<u>20,546</u>	<u>(35)</u>	<u>3,714</u>	<u>22,768</u>
NET INCOME FROM ADMINISTRATIVE ACTIVITIES					
Operating Revenues	3,826	1,891	2,290	1,769	2,768
Operating Expenses	<u>(19,543)</u>	<u>(20,381)</u>	<u>(20,218)</u>	<u>(18,810)</u>	<u>(17,675)</u>
Net Administrative Activities Expense	<u>(15,717)</u>	<u>(18,490)</u>	<u>(17,928)</u>	<u>(17,041)</u>	<u>(14,907)</u>
NET INCOME FROM INSURANCE ACTIVITIES					
Life and Disability Coverage	5,290	160	3,570	(5,424)	(13,781)
Fire and Hazard Coverage	<u>1,110</u>	<u>2,086</u>	<u>326</u>	<u>(538)</u>	<u>(4,202)</u>
Net Insurance Activities Income (Expense)	<u>6,400</u>	<u>2,246</u>	<u>3,896</u>	<u>(5,962)</u>	<u>(17,983)</u>
TOTAL DEFICIENCY OF REVENUES AND TRANSFERS OVER EXPENSES	<u>(8,832)</u>	<u>4,302</u>	<u>(14,067)</u>	<u>(19,289)</u>	<u>(10,122)</u>
RETAINED EARNINGS	<u>\$ 269,569</u>	<u>\$ 278,401</u>	<u>\$ 274,099</u>	<u>\$ 288,166</u>	<u>\$ 307,455</u>

Department's Discussion of Financial Data

The 1943 Fund, which is the sole operating fund for the Program, reflects a retained earnings balance of \$269,569,000 as of June 30, 1999. This represents a \$8,832,000 decrease compared to FY 1998 and is approximately 15.1% below the level at the beginning of FY 1995. Although retained earnings have decreased in four of the last five years, the overall asset-to-liability ratio for the 1943 Fund has remained nearly constant at approximately 108% during the same period. The deficiency of revenues over expenses for the Program for FY 1999 was \$8,832,000 compared to an excess of revenues over expenses of \$4,302,000 in FY 1998. The aggregate net deficiency of revenues for the Program during the five-year period reflected in the tables above was \$48,008,000.

As further described below, the Program has experienced significant losses during four of the last five years for four principal reasons: (i) a low interest rate environment that produced high prepayment levels and decreased investment earnings on invested funds from FY 1995 through FY 1998; (ii) reductions of interest rates on existing Contracts of Purchase (as discussed below) in excess of the near term reduction of interest expense achieved through bond refundings in 1997 and 1998; (iii) losses on sale of repossessed properties and allowances for losses associated with the Department's portfolio of Contracts of Purchase from FY 1995 through FY 1998; and (iv) financial losses associated with the Department's self-insured life and disability and property insurance programs during FY 1995 and FY 1996. However, as discussed below, over the last several years the Department has undertaken major initiatives to address each of these areas and expects such actions to have a positive impact on future years' financial performance.

The Program's FY 1999 net interest income (total interest income less bond interest expense) of \$14,246,000 was \$6,477,000 less than FY 1998. During the first three years represented in the table above net interest margin (net interest income divided by average interest bearing assets) improved, reflecting the Department's continuing efforts during the period to reduce debt service cost and increase interest income. These efforts have included, where possible, redemption of outstanding higher interest rate bonds prior to maturity and the transfer of certain invested funds from lower yielding variable rate instruments to higher yielding fixed rate investments. Notwithstanding these recent actions, the Department's net interest margin declined from 0.65% in FY 1997 to 0.41% in FY 1999 and will continue to be adversely affected in future years by the: (i) reduction of the interest rate on existing Contracts of Purchase from 8.00% to 6.95% implemented effective April 1, 1998; and (ii) \$792,110,000 (as of June 30, 1999) of outstanding Veterans G.O. Bonds issued in series without early redemption provisions, with average interest costs of approximately 9.00% and which cannot be fully retired before the year 2010 (see Exhibit 2 to this APPENDIX B – "Certain Department Financial Information and Operating Data – Veterans G.O. Bonds and Prior Revenue Bonds").

In addition, income was negatively affected in FY 1999 compared to FY 1998 by a \$13,428,000 decline in the effect of realized and unrealized gains on securities due to changes in market value. During FY 1999, such income was also negatively affected by full-year amortization of \$6,342,000 of the financing and redemption costs relating to the issuance of the 1997/1998 Tax Plan Bonds and subsequent similar costs, and by premium costs of \$2,330,000 relating to the purchase of private mortgage insurance with respect to certain Contracts of Purchase – both of which are expected to represent recurring expenses for future years' operations.

Like all loan portfolios, the Program experienced fluctuating levels of prepayments and new originations of Contracts of Purchase primarily influenced by the rates of interest of conventional mortgage financing relative to the Program's interest rates (either 8.00% or 7.75% during the period reflected in the table above until March 31, 1998, and 6.95% thereafter). The net effect of these factors resulted in the outstanding principal balance of Contracts of Purchase declining 14.1% since June 30, 1995. (See Exhibit 2 to this APPENDIX B "Certain Department Financial Information and Operating Data" for detailed information regarding the history of repayments, prepayments and originations of Contracts of Purchase.) During the first three years of such period, cash and invested funds dropped 20.3% due primarily to the use of such assets to pay bond maturities or redeem bonds and fund new Contracts of Purchase. During FY 1998, cash and investments increased by \$422,126,000 primarily as the result of issuance of the 1997/1998 Tax Plan Bonds which provided \$353 million of new funds to originate Contracts of Purchase. During FY 1999 cash and investments declined \$137,744,000 due primarily to the use of proceeds of the 1997/1998 Tax Plan Bonds to originate new Contracts of Purchase. In aggregate, total Program assets have declined 12.3% since June 30, 1995. The debt structure of the Program, however, accommodated this downward trend in assets through a series of bond redemptions which resulted in a similar reduction in the bonds outstanding. Other non-current assets increased by \$18,139,000 compared to June 30, 1997 due primarily to the capitalization of financing and redemption costs relating to the 1997/1998 Tax Plan Bonds. Such non-income producing assets will be amortized over the term of the 1997/1998 Tax Plan Bonds and will have a negative effect on net income during such period.

Due to the decline in real estate values in certain California housing sub-markets in the early 1990's and the concentration of the Department's Contract of Purchase portfolio in certain areas of the State which were economically depressed due to military base closures and defense industry employment reductions, the number of repossessed properties ("REOs") and their loss on sale increased significantly between FY 1992 and FY 1997. However, the principal balance of Contracts of Purchase classified as REOs decreased by \$46,469,000 from June 30, 1997 to June 30, 1999 compared to a \$42,738,000 cumulative increase over the preceding four-year period. Beginning in FY 1996, the Department moved aggressively to repossess properties of canceled Contracts of Purchase and dispose of its REOs. In conjunction with this effort, the Department reassessed the adequacy of its loss reserves and, over the five-year period FY 1994 to 1998, took cumulative net charges to its operating income by \$50,804,000 to provide for potential losses in the portfolio. During FY 1999, the Department's loss allowance was reduced by \$3,343,000 due to the adequacy of reserves funded in prior years and improvement in the overall performance of the Contracts of Purchase portfolio. As a result of actual losses realized in the disposition of REO properties and management of the Contracts of Purchase portfolio, accumulated loss reserves decreased \$21,048,000 or 41.7% over the last two years. The remaining loss reserve of \$29,367,000 at June 30, 1999, together with the Department's (a) purchase of primary mortgage insurance during FY 1998 with respect to more than \$769 million of existing Contracts of Purchase with high LTV ratios; and (b) imposition of USDVA guaranties for most high LTV Contracts of Purchase originated beginning in April 1998 (see "THE PROGRAM - Loan Insurance" in this APPENDIX B), are intended to provide for future potential REO losses.

Program administrative operating expenses declined 4.1% in FY 1999. After taking into account a \$1,935,000 increase in operating revenue, net administrative operating expenses decreased 15.0% over FY 1998 results.

Effective June 1, 1996, the Department's self-insured life and disability coverage plan was transferred to a fully-insured plan underwritten by an outside commercial insurer except for that portion of the program covering existing claims of disabled Contract of Purchase holders for whom the Department continues to provide coverage. Loss reserves for these obligations have been actuarially based. More than two-thirds of such loss reserves are funded and maintained under a third party administrator agreement. The remaining amount is unfunded, but reserved in the form of an accrued liability. The net effect of these changes resulted in the plan producing positive income since FY 1997 compared to aggregate losses of \$36,373,000 over the four preceding fiscal years.

Effective November 1, 1996, a number of changes were made to the Department's fire and hazard insurance coverage, including increasing the deductible, eliminating outdated loss coverages and limiting the claims period. These changes have resulted in stabilized financial operations for the Department's fire and hazard coverage over the last four fiscal years.

Further financial information relating to the 1943 Fund can be located in Exhibit 1 to this APPENDIX B in this Official Statement.

External Reviews of the Program

The Program has been, and currently is, the subject of reviews by the executive and legislative branches of State government. The focus of these reviews has been various public policy concerns relating to the Program, including whether new loan originations under the Program should be terminated and how funds generated by the Program should be applied. The Department does not believe that either termination of the loan originations or use of the Department's moneys to fund other programs, if either or both of these policies were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds.

The Legislative Analyst's Office for the State of California (the "LAO"), on January 16, 1998, issued a report entitled "Rethinking the Cal-Vet Loan Program." On February 16, 1999, the LAO issued an analysis of the then proposed Governor's Budget 1999/2000, which analysis included a discussion of the Department. (The report and the analysis are referred to collectively as the "1998-99 LAO Reports.") The stated purpose of the LAO is to provide analysis and nonpartisan advice to the California Legislature on fiscal and policy issues. The LAO is overseen by the Joint Legislative Budget Committee, a 14-member bipartisan committee composed of an equal number of State Assembly and State Senate members.

In the 1998-99 LAO Reports, the LAO analyzed the historical and recent financial performance and lending activities of the Department and made various recommendations. The 1998-99 LAO Reports described the financial losses experienced by the Department, the increasing rate of repayment of Contracts of Purchase, and the decreased lending activity in recent years. The 1998-99 LAO Reports attributed the decreased lending activity principally to more attractive loan programs available from other sources and to a dwindling population of eligible veterans. The budget analysis stated that the Department's completed and proposed programmatic changes (including changing from the uniform interest rate) had improved borrower demand, although less than the Department had projected, and the Department's bond restructuring program, implemented with the sale of over \$1.4

billion of Veterans G.O. Bonds and Revenue Bonds in 1997 and 1998, had improved the Department's financial operations. The 1998-99 LAO Reports were issued before the impact of the Department's recent programmatic changes had been realized.

However, the LAO's analysis of the interests of the State and of the future needs of veterans and funding sources led the LAO to make several recommendations, which included increased oversight of the Department, ending new loan origination after the year 2007, and use of Department moneys which the LAO considered "surplus" for the benefit of veterans and State taxpayers. The 1998 report stated that any redirection of "surplus funds should be accomplished carefully by means that ensure that all obligations of the State to Bondholders are met." Any further actions on the 1998-99 LAO Reports would result from legislative changes that would be proposed by the Legislature and signed by the Governor. In addition, the LAO budget analysis states that any such use of the funds the LAO characterized as "surplus" would have to be authorized through a ballot measure.

On February 17, 2000, the LAO issued an analysis of the proposed Governor's Budget 2000/2001, which analysis included a discussion of the Department. In this report, the LAO notes a continuous increase in overhead costs of the Program over recent fiscal years. The report recognizes that the administrative costs of the Program are not part of the State budget, but recommends that the Department report to the State Legislature during budget hearings on the reasons for such cost increases and the steps it is taking to reduce those costs. The 2000 report referenced the 1998 report and states that no significant changes have occurred in the Program since the 1998 report with respect to the matters addressed in that report.

In his proposed budget for Fiscal Year 1999-2000, Governor Davis cited the 1998 report when discussing the Department, and referred to "a basic dilemma: there is a declining interest or need for home loans and an increasing need for other services for veterans." The Governor listed several steps intended to improve the operation of State programs for veterans. Those most relevant to the Program are (a) appointment of an internal auditor for the Department, (b) a request to the Bureau of State Audits to conduct a fiscal and program compliance audit of the Program, which, with other studies, will lay the groundwork for corrective action, and (c) direction to the Secretary of Veterans Affairs to report within 6 months to the Governor on the need for further restructuring of the Program and on ways that the "surplus funds in the home program" might be redirected to other pressing needs of veterans.

On October 10, 1999, Governor Davis signed into law Assembly Bill 92, which creates the Office of Inspector General for Veterans Affairs. The Governor has appointed an Inspector General, effective January 1, 2000. Such appointment is subject to confirmation by the Senate. The Inspector General is responsible for reviewing the operations and financial condition of all veterans programs supported by the State, which includes the Program.

As directed by the Governor's budget language for Fiscal Year 1999-2000, on July 12, 1999 the Department submitted a report to the Governor which addressed the Department's intent to further enhance the programmatic changes implemented in the 1997/1998 restructuring plan and advised the Governor that there are no "surplus" funds in the home program as the term implies. No new directives have been issued to the Department.

On September 28, 1999, the Bureau of State Audits received a formal request from a State Legislator to conduct an audit of the Department and the Program. The legislative request called for assessment of, among other things, whether the Department achieves its mission with its programs, the financial condition of the Program and the reasonableness and appropriateness of expenditures, the relationship of the Department's lending standards to those in the lending industry and whether those standards are adhered to in the Department's lending process, and the demographics of eligible war veterans and the impact thereof on the Program's viability. Such audit is currently underway and the Department has been informed that the initial phase of the audit, which is expected to result in recommendations to be discussed with the Department, may be completed as early as May 2000. Although the Department cannot predict the outcome of this audit, the recommendations of the Bureau of State Audits may conform to the analysis contained in the 1998/99 LAO Reports and may include a call for an end to loan originations and diversion of funds from the 1943 Fund to other veterans' (or other governmental) purposes. If, following discussions with the Department, the Bureau of State Audits formally recommends one or both such actions, implementation of the recommendations will require the support of the executive branch of State government and may require legislative action and voter approval.

The financial performance of and loan origination by the Department are discussed elsewhere in this Official Statement. The Department does not believe that either termination of loan originations or use of Department moneys to fund other programs, if either or both of these policies were implemented, would have an adverse impact on the Department's ability to pay scheduled principal of and interest on any Veterans G.O. Bonds or Revenue Bonds. While the Legislature could enact any or all of the recommendations in the LAO Report or any recommendations of the Bureau of State Audits, use of moneys in the 1943 Fund for veterans benefits outside of the Program may be subject to approval by the electorate of the State and may also be subject to other legal restrictions.

Litigation

On June 25, 1996, the Department was served with a summons and complaint initiating a lawsuit entitled *John L. Debbs, et al. v. California Department of Veterans Affairs, et al.* (Superior Court of California, County of Los Angeles, Case No. BC 151476). The third amended complaint alleges "fraudulent concealment, declaratory relief, injunctive relief, and damages for monies unlawfully taken from the California Veterans Farm and Home Life and Disability Protection Plan." Plaintiff claims that in 1983, when the Department canceled its contracts with two life insurance companies then responsible for underwriting the life and disability programs, over \$100 million was illegally expended by the Department, and that certain transfers from the life and disability reserves to the 1943 Fund were unlawful. The complaint seeks, among other things, that premiums under the life and disability program be reduced to prior levels and the return of the moneys, plus interest, from the 1943 Fund to the life and disability reserves. Plaintiffs' attempts to obtain a preliminary injunction and temporary restraining order from the court have been unsuccessful. Plaintiffs sought to convert this action into a class action suit. The court certified the class action but ordered the Plaintiffs' attorney to pay the cost of notifying the class. The court ordered Plaintiffs to provide notice to the class by December 27, 1999. However, prior to class notification, Plaintiffs' attorney filed a motion to have the Court Commissioner removed from the case. Therefore, all action on the case is stayed until a decision is made as to the removal of the Commissioner. Once notice to the class is complete, summary judgment motions will be scheduled.

The Department is vigorously opposing this class action lawsuit. While the outcome of any litigation cannot be predicted with certainty, the Department expects ultimately to prevail in this matter. Even if the respective Plaintiffs should prevail in this matter, the Department does not expect such outcome to affect its ability to make timely payment of debt service on the Veterans G.O. Bonds or the Revenue Bonds.

In 1997, John L. Debbs and his wife filed a separate federal court action. In 1998, Mr. and Mrs. Debbs filed an additional federal court action, essentially repeating the charges and damages contained in the 1997 action. Both federal court actions have been dismissed by the court and no further appeals are available.

Excess Revenues

The Department has covenanted with the holders of its Revenue Bonds to apply Revenues received with respect to Contracts of Purchase, after payment or reimbursement of debt service on Veterans G.O. Bonds, in a specified order of priority. For this purposes, "Revenues" means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the revenue account established under the resolution authorizing the issuance of revenue bonds (the "Revenue Bond Resolution"), (iii) amounts transferred to the revenue account from the bond reserve account or the loan loss amount established under the Revenue Bond Resolution and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and liquidation/insurance proceeds, except to the extent not included as "Revenues" pursuant to the provisions of any resolution authorizing the issuance of a series of Revenue Bonds.

The Department has covenanted with the Revenue Bond holders to administer the 1943 Fund and the Program and perform its obligations to such holders in accordance in all material respects with the then-current Program Operating Procedures. The Program Operating Procedures are operating policies of the Department governing the discretionary activities of the Department under the Revenue Bond Resolution. The Department may amend the Program Operating Procedures. The Program Operating Procedures will affect the Excess Revenues that will become available to redeem the Bonds.

The Department has covenanted with the Revenue Bond holders to apply Revenues in the following order, after paying, or reimbursing for payments of, debt service on Veterans G.O. Bonds, including the costs of liquidity and credit enhancement facilities related thereto, and setting aside moneys as required under the Federal Tax Code to preserve the tax-exempt status of certain Veterans G.O. Bonds and Revenue Bonds, (1) to pay debt service on Revenue Bonds, (2) to pay the costs of liquidity and credit enhancement facilities, if any, for Revenue Bonds, (3) to replenish certain reserve funds established for the Revenue Bonds, (4) if the Department elects, to pay Department expenses, (5) to set aside a monthly accrual of Veterans G.O. Bond debt service, (6) if the Department elects, to finance Contracts of Purchase and (7) with respect to Excess Revenues and certain tax restricted

moneys, to redeem Veterans G.O. Bonds, including the Bonds, and Revenue Bonds. For such purposes:

(a) "Excess Revenues" means, as of any date of calculation, Revenues in excess of Accrued Debt Service;

(b) "Accrued Debt Service" means, as of any date of determination and, as the context requires, with respect to all Revenue Bonds and Veterans G.O. Bonds (including the Offered Veterans G.O. Bonds), the sum of:

(i) the aggregate amount of scheduled interest and principal (except to the extent otherwise to be redeemed pursuant to clause (i) or (ii) below) to become due after such date but on or before the end of the current debt service year, less the product of (i) the number of whole months remaining in the current debt service year and (ii) the Monthly Debt Service Requirement;

(ii) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the revenue account created under the Revenue Bond Resolution; and

(iii) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding debt service year, to the extent that such obligation arises on account of amounts on deposit in such revenue accounts; and

(c) "Monthly Debt Service Requirements" means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the debt service year in which such date falls, as computed on the first day of such debt service year.

Maintenance of Fund Parity

The Revenue Bond Resolution requires the Department to calculate "Fund Parity" at least annually. "Fund Parity" means (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the accounts established under the Revenue Bond Resolution, and (ii) the principal amount of all Revenue Bonds and Veterans G.O. Bonds outstanding (plus accrued interest) reduced by (b) defined allowances and reserves for loss coverage on Contracts of Purchase and life and disability coverage on persons obligated under Contracts of Purchase. If any such calculation shall not reflect that Fund Parity at least equals the percentage required by the Revenue Bond Resolution, the Department may be required to expend Excess Revenues to redeem Revenue Bonds until its recalculations of Fund Parity meet the test required by the Revenue Bond Resolution.

EXHIBIT 1

**FINANCIAL STATEMENTS OF THE 1943 FUND
FOR FISCAL YEARS 1999 AND 1998
AND INDEPENDENT AUDITORS' REPORT**

**VETERANS FARM AND HOME BUILDING FUND OF 1943
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

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**VETERANS FARM AND HOME BUILDING
FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS,
STATE OF CALIFORNIA**

Financial Statements for the Years Ended June 30, 1999
and 1998 and Independent Auditors' Report

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**INDEPENDENT AUDITORS' REPORT**

To the California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund (Fund) of 1943, which is administered by the Department of Veterans Affairs of the State of California (Department) as of June 30, 1999 and 1998, and the related statements of revenues, expenses and changes in retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial position of the Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs of the State of California as of June 30, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The year 2000 supplementary information on page 15 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because of the unprecedented nature of the year 2000 issue and its effects, and the fact that authoritative measurement criteria regarding the status of remediation efforts have not been established. In addition,

we do not provide assurance that the Department is or will become year 2000 compliant. that the Department's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Fund does business are or will become year 2000 compliant.

Deloitte's Touche LLP

October 1, 1999'

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

BALANCE SHEETS

JUNE 30, 1999 AND 1998 (in thousands)

	1999	1998
ASSETS		
Cash in State Treasury		\$ 6,553
Investments:		
Unrestricted	\$ 464,965	571,598
Restricted	849,351	873,909
Insurance administrators	32,423	42,673
	<u>1,346,739</u>	<u>1,488,180</u>
Total cash and investments	1,346,739	1,494,733
Receivables under contracts of sale, net of allowance for uncollectible contracts of \$21,263 and \$22,005 in 1999 and 1998	2,019,324	2,013,874
Due from Veterans Debenture Revenue Fund	22,471	12,686
Interest receivable:		
State of California's Surplus Money Investment Fund	3,998	3,101
Other investments	8,214	9,608
Due from other funds	6,123	1,046
Other real estate owned, net of allowance for losses of \$8,104 and \$19,003 in 1999 and 1998	20,565	43,869
Land, improvements and equipment, net of accumulated depreciation of \$6,986 and \$5,972 in 1999 and 1998	7,578	8,620
Other	<u>466</u>	<u>92</u>
TOTAL ASSETS	<u>\$3,435,478</u>	<u>\$3,587,629</u>
LIABILITIES AND RETAINED EARNINGS		
LIABILITIES:		
Cash overdraft due to State Treasury	\$ 6,393	
Accrued interest and other liabilities	49,976	\$ 58,458
Bonds payable - net	3,066,387	3,194,526
Insurance claims payable and loss reserves	<u>43,153</u>	<u>56,244</u>
Total liabilities	3,165,909	3,309,228
RETAINED EARNINGS	<u>269,569</u>	<u>278,401</u>
TOTAL LIABILITIES AND RETAINED EARNINGS	<u>\$3,435,478</u>	<u>\$3,587,629</u>

See notes to financial statements.

**VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
YEARS ENDED JUNE 30, 1999 AND 1998 (in thousands)**

	1999	1998
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of sale of properties	\$ 139,839	\$ 162,086
Investments and other	74,079	78,621
Transfers of revenue from Veterans Debenture Revenue Fund	<u>887</u>	<u>8,441</u>
Total program operations revenues	214,805	249,148
Expenses:		
Interest expense	201,772	218,757
Provision for contract losses (reversal)	<u>(3,343)</u>	<u>1,312</u>
Total program operations expenses	<u>198,429</u>	<u>220,069</u>
Excess of program operations revenues over program operations expenses	<u>16,376</u>	<u>29,079</u>
PROGRAM ADMINISTRATION:		
Revenues:		
Loan servicing fees	3,261	1,594
Other income	565	297
Excess of amounts charged to contract holders over fire and hazard insurance claims and expenses and changes in insurance reserves	1,110	2,086
Excess of amounts charged to contract holders and changes in insurance reserves over self-insured life and disability claims and expenses	<u>1,957</u>	<u> </u>
Total program administration revenues	6,893	3,977
Expenses:		
Payroll and related costs	11,171	11,404
General and administrative expenses	17,044	13,596
Excess of self-insured life and disability insurance claims and expenses and changes in insurance reserves over amounts charged to contract holders	<u> </u>	<u>626</u>
Total program administration expenses	<u>28,215</u>	<u>25,626</u>
Excess of program administration expenses over program administration revenues	<u>(21,322)</u>	<u>(21,649)</u>
LOSS ON SALE OF REPOSSESSED PROPERTY	<u>(3,886)</u>	<u>(3,128)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES	(8,832)	4,302
RETAINED EARNINGS:		
Beginning of year	<u>278,401</u>	<u>274,099</u>
End of year	<u>\$ 269,569</u>	<u>\$ 278,401</u>

See notes to financial statements

VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 1999 AND 1998 (in thousands)

	1999	1998
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (deficiency) of revenues over expenses	\$ (8,832)	\$ 4,302
Adjustments to reconcile to net cash used by operating activities:		
Amortization of bond premiums, discounts and issuance costs	3,207	2,494
Depreciation expense	1,042	727
Loss on sale of repossessed property	3,886	3,128
Effect of changes in assets and liabilities:		
Interest receivable - State of California's Surplus Money Investment Fund	(897)	(2,624)
Interest receivable - other investments	1,394	8,158
Due from other funds	(5,077)	3,307
Other real estate owned	19,418	4,038
Other assets	(374)	884
Accrued interest and other liabilities	(8,482)	(22,044)
Insurance claims payable and loss reserves	(13,091)	(12,839)
Net cash used by operating activities	(7,806)	(10,469)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net (increase) decrease in receivables under contracts of sale	(5,450)	113,856
Net (increase) decrease in investment securities	141,441	(421,607)
Purchase of land, improvements and equipment		(1,513)
Net cash provided (used) by investing activities	135,991	(309,264)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Increase in cash overdraft due to State Treasury	6,393	
Proceeds from sales of bonds	591,755	1,613,366
Maturities of bonds payable	(82,235)	(1,325,996)
Early redemption of bonds payable	(640,866)	(48,650)
Net (increase) decrease in Due from Veterans Debenture Revenue Fund	(9,785)	74,793
Net cash provided (used) by financing activities	(134,738)	313,513
DECREASE IN CASH IN STATE TREASURY	(6,553)	(6,220)
CASH IN STATE TREASURY:		
Beginning of year	6,553	12,773
End of year	\$ -	\$ 6,553

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 1999 AND 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description - The California Department of Veterans Affairs (the Department) is a separate legal entity and a Cabinet level agency of the State of California. A seven-member California Veterans Board (the Board) has policy oversight of the operations of the Department. The Board's membership consists of the Department Secretary and six members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the Fund) was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the Legislature are used for contract loans to veterans. Expenditures are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Veterans Farm and Home Building Fund of 1943, and are not intended to present the financial position of the Department of Veterans Affairs of the State of California and the results of its operations and cash flows of its proprietary fund types. The financial statements of the Fund are included in the financial statements of the State of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Use of Estimates in the Preparation of Financial Statements - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting - The Fund has been classified as a governmental proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and expenses are recognized as incurred.

Cash and Investments - The Department reports all investments at fair value except for certain nonparticipating fixed interest investment contracts which are valued using cost based measures. The fair value of investments is based on published market prices and quotations from major investment brokers and from the State of California for the Surplus Money Investment Fund. Uncommitted bond proceeds restricted for loans to veterans are reflected in the balance sheet as restricted cash and investments.

Receivables Under Contracts of Sale - Receivables under contracts of sale consist of the remaining contract principal balance plus unpaid interest accrued to date, net of the reserve for uncollectible accounts. The contract balance may also include amounts paid by the Fund for property taxes and insurance pending reimbursement from the contract holder.

Allowance for Uncollectible Contracts - The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation.

Contract Guarantees and Primary Mortgage Insurance - During 1998, the Department started collecting a contract guarantee fee on all contracts with down payments less than 20%. Such contracts are classified as high loan to value (HLTV) contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs (USDVA) or primary mortgage insurance. For certain HLTV contracts not eligible for USDVA guarantees, the Fund purchases primary mortgage insurance (PMI) from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned - Real estate acquired by repossession is carried at the lower of the contract balance or its net realizable value. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses.

Insurance Claims Payable and Loss Reserves - Insurance claims payable and loss reserves include unpaid claims, incurred but not reported (INBR) claims and loss reserves for the fire and hazard insurance plan and the benefits payable under the Department's remaining self-insured life and disability protection plan.

Fire and Hazard Insurance - This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred and the change in loss reserves is included as a net amount in the statement of revenues, expenses and changes in retained earnings.

Self-Insured Life and Disability Protection Plan - Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan which include future disability and life benefits were derived from an actuarial evaluation performed in 1997. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%.

Amortization of Bond Premiums, Discounts and Issuance Costs - Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

New Accounting Pronouncements - In June 1999, the Governmental Accounting Standards Board issued Statement of Governmental Accounting Standards ("SGAS") No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*. The statement establishes financial reporting standards for certain governmental entities which will require expanded

financial information, management discussion and analysis and required supplemental information in their financial reporting. This statement will be effective for the Department for the year ended June 30, 2002. The Department has not determined what effect adopting SGAS No. 34 will have on the Fund's financial statements.

2. CASH AND INVESTMENTS

The cash overdraft of \$6,393,464 as of June 30, 1999 represents a liability due to the State Treasury. Cash in the State Treasury of \$6,552,580 as of June 30, 1998 represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other State agencies and invested by the State Treasurer's office. These assets are not individually identifiable.

Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments, including direct obligations of the U.S. Government and its agencies, the State of California's Surplus Money Investment Fund, and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, is authorized by California law. In addition, the Department has restricted \$5,000,000 plus interest accrued since February 1, 1998, for potential life and disability rate increases after January 31, 2002.

The Fund's investments in master investment agreements totaling \$890,692,585 as of June 30, 1999 are carried at cost. The interest rates on investment agreements are fixed and range from 4.98% to 5.91%. The investment agreements expire from 2000 to 2029.

All of the Fund's investments in U.S. Treasury notes and bonds, corporate bonds, and the amounts administered by the insurance company are categorized as risk category 1, which is defined by GASB Statement No. 3 as investments that are insured or registered or for which the securities are held by the Fund or its agent in the Fund's name. In accordance with GASB Statement No. 3, the Fund's investments held in the State of California's Surplus Money Investment Fund, the investment agreements and the mutual fund are not categorized as to risk.

The Fund's investments at June 30, 1999 and 1998 are as follows (in thousands):

	1999	1998
Category 1		
U.S. Treasury notes and bonds	\$ 183,645	\$ 187,851
Amounts held in trust fund with insurance administrators:		
U.S. Treasury notes	15,627	15,331
Corporate bonds	9,596	16,186
Other	4,371	4,378
Investments Not Subject to Categorization		
State of California's Surplus Money Investment Fund	239,979	318,768
Investment agreements (at cost)	890,692	938,888
Amounts held in trust fund with insurance administrators:		
Mutual fund	<u>2,829</u>	<u>6,778</u>
	<u>\$ 1,346,739</u>	<u>\$ 1,488,180</u>

3. RECEIVABLES UNDER CONTRACTS OF SALE

The Fund retains title to all real property subject to contracts of sale until the contract is satisfied. The veteran's contracts have original terms of 25-30 years and bear interest at rates of 4.4% to 11.0%, depending on the age and type of contract and the classification of the current contract holder. During 1998, the Department lowered the rate on most contracts from 8.0% to 6.95%.

4. BONDS PAYABLE

At June 30, 1999 and 1998, bonds payable included the following (in thousands).

	1999	1998
General obligation bonds of the State of California, annual interest rates from 4.1% to 11.0% due in varying annual installments through 2032 (subject to varying redemption provisions)	\$2,687,390	\$2,947,165
Home purchase revenue bonds, annual interest rates from 3.9% to 5.5%, due in varying annual installments through 2028 (subject to varying redemption provisions)	<u>404,215</u>	<u>275,055</u>
	3,091,605	3,222,220
Discounts	(4,276)	(4,358)
Premiums		214
Unamortized bond origination costs	(12,370)	(11,454)
Unamortized bond redemption premiums	<u>(8,572)</u>	<u>(12,096)</u>
Total	<u>\$3,066,387</u>	<u>\$3,194,526</u>

Future scheduled bond maturities at June 30, 1999 are as follows (in thousands):

2000	\$ 186,255
2001	108,825
2002	112,660
2003	111,755
2004	125,980
Thereafter	<u>2,446,130</u>
	<u>\$3,091,605</u>

General obligation bonds of the State of California are payable in accordance with the various veterans bond acts by the State General Fund. The full faith and credit of the State of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the General Fund of the State of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund. Authorized and unissued bonds under the Veterans Bond Acts of 1990 and 1996 at June 30, 1999 and 1998 were \$176,835,000.

Revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Veterans Farm and Home Building Fund of 1943 and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the \$1.5 billion ceiling authorized in 1987 less revenue bonds outstanding at that time. At June 30, 1999 and 1998, authorized and unissued revenue bonds were \$1,095,785,000 and \$1,224,945,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount equal to at least three percent of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A Bonds, 1997 Series B Bonds, 1997 Series C Bonds, 1998 Series A Bonds, 1999 Series A Bonds and 1999 Series B Bonds), a requirement equal to at least seven percent of the outstanding principal amount of such Revenue Bonds. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and the interest on the Revenue Bonds and for making Mandatory Sinking Fund Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 1999 and 1998 the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the California Department of Veterans Affairs.

5. BOND REFUNDING

During fiscal year 1999, the Department issued General Obligation bonds totaling \$351,500,000 and Home Purchase Revenue bonds totaling \$240,255,000 with an average interest rate of 5.02%. Certain bond proceeds from the General Obligation bond issues and certain proceeds from the Home Purchase Revenue bond issues were used to refund previously issued General Obligation bonds of \$485,740,000, and Home Purchase Revenue bonds of \$106,015,000.

For those bonds that could not be called for immediate redemption, approximately \$17,295,000 is deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liability for those bonds is not included in the Fund's balance sheet.

During the 1999 fiscal year, the escrow trustee retired approximately \$293,191,000 of bonds which were considered defeased as of June 30, 1998.

6. FIRE AND HAZARD INSURANCE

Fire and hazard insurance coverage is provided on behalf of contract holders for substantially all properties subject to contracts of sale. The program is funded by amounts charged to contract holders which are considered appropriate to cover losses incurred, premiums paid for excess insurance coverage and administration fees. From the amounts charged to contract holders, the Department pays losses up to \$1,500,000 per occurrence or \$12,000,000 per policy year. Coverage in excess of the above amounts is provided under a master policy with an insurance carrier which also administers the program. The loss reserve is based on the third party administrators estimate of incurred but not reported claims based on the historical trends and loss experience within the portfolio.

The excess of premiums charged to contract holders over claims, expenses and change in loss reserves for the year ended June 30, 1999 and 1998 was as follows (in thousands):

	1999	1998
Amounts charged to contract holders	\$ 8,820	\$ 9,788
(Less) plus:		
(Increase) decrease in estimated loss reserve	(370)	29
Claims loss expense	(6,213)	(6,418)
Master policy premium	(478)	(532)
Administrative fees	<u>(649)</u>	<u>(781)</u>
Excess of amounts charged to contract holders over claims and expenses and changes in reserves	<u>\$ 1,110</u>	<u>\$ 2,086</u>

7. SELF-INSURED LIFE AND DISABILITY PROTECTION PLAN

The Department was responsible for a self-insured life and disability protection plan for all contract holders until June 1, 1996. At that time, except for contract holders receiving benefits, the self-insured life and disability protection plan was replaced by an interim life and disability insurance plan provided by a commercial insurer, Pacific Mutual Group (PMG). Effective February 1, 1998, PMG was selected to provide a replacement, long-term life and disability plan.

As of June 30, 1999, the Department remains self-insured for approximately 1,018 remaining contract holders. Under the provisions of the self-insured plan benefits continue until the beneficiary returns to active employment, dies or their contract is paid off. Loss reserves for these obligations have been actuarially determined. A portion of the required loss reserves are maintained under a third party administrator (TPA) agreement and are shown in the financial statements as investments with insurance administrators. During the year, the TPA reserves have been used to satisfy benefits payable under the self-insured protection plan. Earnings on investments held by the TPA were \$2,836,005 and \$2,976,337 in 1999 and 1998, respectively, and are included in interest revenues - investments and other in the financial statements.

The excess of claims expenses, changes in loss reserves, and administrative expenses over plan revenues whose coverages continue as obligations of the self-funded life and disability protection plan for the years ended June 30, 1999 and 1998 was as follows (in thousands):

	1999	1998
Claims expenses:		
Life insurance program	\$ (941)	\$ (1,836)
Disability insurance program	<u>(10,102)</u>	<u>(11,510)</u>
Total claims expenses	(11,043)	(13,346)
Decrease in estimated loss reserves	<u>13,267</u>	<u>12,810</u>
Net claims expenses and change in loss reserves	2,224	(536)
Plus plan revenues:		
Life insurance program	124	157
Disability insurance program	<u>158</u>	<u>179</u>
Total	282	336
Less administrative fees	<u>(549)</u>	<u>(426)</u>
Excess (deficiency) of plan revenues over net claims expense	<u>\$ 1,957</u>	<u>\$ (626)</u>

8. COMMITMENTS AND CONTINGENCIES

As of June 30, 1999 and 1998, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately \$18,313,948 and \$16,017,616, respectively.

The Department is a defendant in certain litigation related to the self-insured Life and Disability Protection Plan, formerly operated by the Department, and other matters. The Department, based on the advice of its counsel, believes that the suits are without merit and intends to vigorously defend its position. Management is of the opinion that the potential liability will not have a material adverse effect on the financial statements.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 1999 and 1998 was \$435,865 and \$462,562, respectively. Lease terms generally range from five to ten years with options to renew for additional periods. As of June 30, 1999, minimum annual rentals under operating leases are as follows (in thousands):

2000	\$ 245
2001	140
2002	34
	<u>\$ 419</u>

9. RETIREMENT PLAN

The Fund, through the Department and the State of California, contributes to the California Public Employees Retirement System (CalPERS), which includes an agent multiple-employer public employee retirement system and a cost sharing multiple-employee plan that acts as a common investment and administrative agent for participating entities within the State of California. Substantially all full-time employees of the Department, whose compensation is paid from the Fund, are members of CalPERS. The Plan provides a monthly allowance based on age, years of credited service, and highest average compensation over an established period of time of one to three years. Vesting occurs after five to ten years. The Plan also provides death and disability benefits. The benefits are established by contract with CalPERS in accordance with the provisions of the Public Employees Retirement Law. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for CalPERS. A copy of that report may be obtained by writing to CalPERS, Central Supply, P.O. Box 1802, Sacramento, CA 95812-1802.

Contributions to the Plan are funded by both the Department and the employee, and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$238 to \$863. With the exception of employees in the second-tier plan, state employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

Contributions by the Department to the Plan for the years ended June 30, 1999 and 1998 were approximately \$625,000 and \$956,000, or approximately 8.3% and 8.4% of participants' salaries, respectively. Employee contributions to the Plan for the years ended June 30, 1999 and 1998 were approximately \$457,000 and \$281,000 or approximately 4.1% and 2.5% of participants' salaries, respectively.

For fiscal years ended June 30, 1999 and 1998, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution was determined as part of the June 30, 1997 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.25% investment rate of return, and (b) projected salary increases that vary by duration of service. Both (a) and (b) included an inflation component of 3.5%. The actuarial value of the Department's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 1997 was 32 years. Three-year fund trend information is as follows:

Three-Year Fund Trend Information

Fiscal Year End	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 1997	\$ 1,042,000	100 %	\$ -
June 30, 1998	\$ 956,000	100 %	\$ -
June 30, 1999	\$ 625,000	100 %	\$ -

The most recent actuarial valuation of CalPERS indicated that there was an unfunded liability for vested benefits due current employee participants in the plan. The amount of the unfunded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 1998 CalPERS CAFR.

Since all state agencies and departments are considered by CalPERS collectively as a single employer, the actuarial value of plan assets, the actuarial accrued liability, the total unfunded liability, the actuarial value of assets as a percentage of the actuarial accrued liability, and the ratio of unfunded actuarial liability to annual covered payroll attributable to the Department's employees, whose compensation is paid from the Fund, cannot be determined.

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CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

Disclosure of Year 2000 Issues and Activity

The Year 2000 (Y2K) date problem could affect a wide range of governmental activities and could have a significant impact on an entity's future financial resources. In response to this concern, the Governmental Accounting Standards Board (GASB) directed governmental entities to disclose information concerning the general description of the Year 2000 issue as it relates to their organization, the resources committed to resolving the Year 2000 problem, and the stage or stages the organization is at in resolving this problem.

The California Department of Veterans Affairs (the "Department") Farm and Home Division has identified the following systems and equipment as critical to assess and remediate, as necessary, to ensure that the systems and equipment are Year 2000 compliant:

- Mortgage Integrated Tracking Accounting System (Mitas)
- Networks
- Telecommunication Systems
- Desktop PCs and Applications

Stages of Work

The Department has contracted with MIS 2000 for a full-time Y2K Project Manager. Additional Y2K project consultants have been hired to inventory and test all critical systems and equipment. The Department critical system, Mitas, has been certified Y2K compliant by the vendor. Noncompliant desktop applications are being replaced with compliant applications. End-users have been surveyed to identify essential business operations or services that require Y2K planning. The Department expects to complete and test its Continuity Plan for Business by October 31, 1999.

Assessment and Remediation Stages

The inventory and testing of equipment is complete. The Department expects to complete the replacement or upgrading of noncompliant PCs by October 31, 1999. Additionally, the Department has corresponded with all vendors, contractors and others regarding their state of Year 2000 readiness as to the matters affecting the Department.

Validation and Testing Stage

The Department has completed extensive and comprehensive testing with the finding that the Department's internal systems appear to be Year 2000 compliant.

Contingency Planning

The Department has documented manual processes and other alternative courses of action in the event Year 2000 issues arise.

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EXHIBIT 2

CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA

Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the current loan to value ratios and geographic distribution of Contracts of Purchase financed under the Program as of December 31, 1999 using proceeds of Veterans G.O. Bonds, Revenue Bonds and other amounts under the 1943 Fund.

Current Loan-to-Value Ratio of Contracts of Purchase⁽¹⁾⁽⁴⁾

	<u>Uninsured</u>	<u>Radian Insured</u>	<u>In Process for Radian Insurance</u>	<u>VA Guaranteed</u>	<u>Total</u>
Single Family Homes					
Less than 30% LTV	\$ 112,750	\$ 168	--	\$ 10	\$ 112,928
30-49% LTV	256,224	1,630	--	268	258,122
50-59% LTV	186,508	1,497	--	--	188,005
60-69% LTV	197,075	3,424	--	311	200,810
70-79% LTV	231,383	39,035	\$ 438	2,433	273,288
Sub-total	<u>\$ 983,939</u>	<u>\$ 45,754</u>	<u>\$ 438</u>	<u>\$ 3,022</u>	<u>\$ 1,033,153</u>
80-84% LTV	\$ 14,634	\$ 135,922	\$ 1,902	\$ 4,738	\$ 157,196
85-89% LTV	25,035	281,056	10,716	16,664	333,471
90-94% LTV	35,349	227,596	25,273	44,366	332,584
95-97% LTV	10,384	16,385	21,044	35,184	82,998
Sub-total	<u>\$ 85,401</u>	<u>\$ 660,960</u>	<u>\$ 58,936</u>	<u>\$ 100,952</u>	<u>\$ 906,249</u>
Greater than 97% LTV	\$ 96,420 ⁽⁵⁾	\$ 1,756	--	\$ 107,625	\$ 205,801
Other Property Types					
Farms	\$ 3,302	--	--	--	\$ 3,302
Mobile Homes in Parks	10,233	--	--	--	10,233
Sub-total	<u>\$ 13,535</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>\$ 13,535</u>
Special Status Contracts of Purchase					
Real Estate Owned ⁽²⁾	\$ 20,906	\$ 2,562	--	--	\$ 23,468
Disability Program ⁽³⁾	34,653	--	--	--	34,653
Sub-total	<u>\$ 55,559</u>	<u>\$ 2,562</u>	<u>--</u>	<u>--</u>	<u>\$ 58,121</u>
Total Portfolio	<u>\$ 1,234,854</u>	<u>\$ 711,032</u>	<u>\$ 59,373</u>	<u>\$ 211,599</u>	<u>\$ 2,216,858</u>

- (1) LTV based on current Contracts of Purchase balance divided by original or updated appraised value of property. Contracts of Purchase are based on the Department's Integrated Loan Processing and Financial Information System.
- (2) Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.
- (3) Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.
- (4) 000's omitted
- (5) Upon amortization to 97% LTV, contracts without a history of delinquency are expected to be insured with Radian.

Geographic Distribution of Contracts of Purchase

County	Approximate Current Contract Balance
Sacramento	\$ 229,621,545
Los Angeles	167,585,781
San Bernardino	156,098,079
San Diego	174,832,634
Fresno	114,504,097
Kern	99,429,214
Riverside	107,372,532
Orange	108,846,730
Placer	69,360,765
San Joaquin	61,499,688
Solano	75,456,467
Shasta	56,629,104
Contra Costa	53,610,751
Other Northern California Counties	410,531,805
Other Central California Counties	251,658,087
Other Southern California Counties	79,820,836
Statewide--California	<u>\$ 2,216,858,116</u>

Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the 1985-86 fiscal year and selected principal repayments with respect to Contracts of Purchase since the 1985-1986 fiscal year.

New Contracts of Purchase During the Fiscal Year⁽¹⁾

Fiscal Year Ending June 30	<u>Veterans G.O. Bonds</u>		<u>Unrestricted Funds</u>		<u>Revenue Bonds</u>		<u>Total</u>	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
1985	4,196	\$ 290,885,900			2,301	\$ 154,244,600	6,497	\$ 445,130,500
1986	3,484	243,955,800			2,401	160,782,200	5,885	404,738,000
1987	1,569	108,789,700			1,160	75,836,800	2,729	184,626,500
1988	2,958	236,054,500			1,397	99,040,900	4,355	335,095,400
1989	3,112	252,796,300			1,154	83,076,100	4,266	335,872,400
1990	2,097	187,445,600			522	38,150,800	2,619	225,596,400
1991	1,927	200,393,500			359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500			388	34,671,600	1,474	146,272,100
1993	740	94,417,100			286	27,443,800	1,026	121,860,900
1994	843	117,213,779			337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376			822	84,860,894	2,931	371,039,270
1996	762	107,751,444			222	22,723,617	984	130,475,061
1997	766	118,344,636			201	21,853,933	967	140,198,569
1998	615	99,224,002	188	\$ 17,716,376	164	18,871,066	967	135,811,444
1999	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982
2000 ⁽²⁾	522	91,052,566	741	137,323,086	355	45,249,213	1,618	273,624,865

(1) Number of new Contracts of Purchase does not include home improvement loans.

(2) 6-month period through December 31, 1999.

**Selected Principal Flows with respect to Contracts of Purchase
Funded by both Veterans G.O. Bonds and Revenue Bonds**

Fiscal Year Ending June 30	Contracts Funded During Year (000s)	Contract Prepayments During Year (000s)	Other Principal Receipts-Losses During Year (000s)	Contract Balance at End of Year (000s)	Average Rate on all Outstanding Contracts	Average Rate on Newly Originated Contracts (2)	Rates		
							Average of Monthly FHLMC 30-year Conventional Loan Rate	Annual Average Prepayment Rate	Annual Average Origination Rate
1985.....	\$ 445,131	\$ 123,669	\$ 88,308	\$ 3,142,526	8.0%		13.8%	4.1%	14.7%
1986.....	404,738	179,809	94,970	3,272,485	8.0		11.5	5.6	12.6
1987.....	184,627	261,675	99,569	3,095,868	7.7		9.8	8.2	5.8
1988.....	335,095	198,396	114,178	3,118,389	7.0		10.5	6.4	10.8
1989.....	335,872	207,471	105,896	3,140,894	7.3		10.6	6.6	10.7
1990.....	225,596	232,085	96,639	3,037,766	8.0		10.1	7.5	7.3
1991.....	229,583	191,895	92,722	2,982,732	8.0		9.9	6.4	7.6
1992.....	146,272	246,150	92,975	2,789,879	8.0		9.0	8.5	5.1
1993.....	121,861	273,817	105,629	2,532,294	8.0		8.0	10.3	4.6
1994.....	151,954	359,749	98,773	2,225,726	8.0		7.3	15.1	6.4
1995.....	371,039	111,984	74,706	2,410,075	7.8		8.7	4.8	16.0
1996.....	130,475	141,767	92,521	2,306,262	8.0		7.5	6.0	5.5
1997.....	140,199	111,254	106,027	2,229,180	8.0		7.9	4.9	6.2
1998.....	135,812	172,134	94,106	2,098,752	7.7		7.2	8.0	6.3
1999.....	255,534	183,776	103,620	2,066,889	6.9	6.4%	6.9	8.8	12.3
2000 ⁽¹⁾	273,625	75,692	47,964	2,216,858	6.9		8.0	7.1	25.6
	<u>\$ 3,887,413</u>	<u>\$ 3,071,323</u>	<u>\$ 1,508,604</u>						

(1) 6-month period through December 31, 1999.

(2) Prior to Fiscal Year 2000, substantially all newly originated Contracts have the same rate as outstanding Contracts. During the first 6 months of Fiscal Year 2000, the interest rates on new Contracts of Purchase were 5.95% for Contracts of Purchase financed using Qualified Mortgage Bond Proceeds, and 6.65% for all other Contracts of Purchase.

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to become available to fund Contracts of Purchase following the expected issuance and remarketing of the Offered Revenue Bonds and 2000 Veterans G.O. Bonds. The table includes bonds issued at short-term rates, the proceeds of which will not become available to finance Contracts of Purchase until the interest rates are adjusted to fixed interest rates to maturity. The universe of veterans eligible to receive Contracts of Purchase financed by the different classifications of available moneys is described under "THE PROGRAM--Qualifying Veteran Status." Additional moneys may become available to finance Contracts of Purchase through the future issuances or remarketings of Veterans G.O. Bonds and Revenue Bonds. The Department has full discretion to use moneys available from prior, current or future bond issues in any order of priority it chooses. As of December 31, 1999, the Department had 902 pending applications for Contracts of Purchase in the aggregate amount of approximately \$148,000,000.

Respective Series Bond Proceeds Subaccounts							
Bond Series	Deposit as of	Balance as of	Unrestricted Moneys ⁽¹⁾	Qualified Veterans Mortgage Bond Proceeds ⁽¹⁾	Qualified Mortgage Bond Proceeds ⁽¹⁾	Investment	Investment Rate (%)
Veterans G.O. Bond Proceeds Subaccounts							
Series BG, BH, BK, BL.....		12/31/99	-0-	\$ 7,447	-0-	Soc Gen ^(2,3)	5.710
		12/31/99	-0-	9	-0-	SMIF	Variable
Series BP.....		12/31/99	-0-	14,000	-0-	Trinity ⁽⁵⁾	5.702
Series BQ/BR.....		12/31/99	-0-	44,357	-0-	Trinity ⁽⁶⁾	5.010
Series BJ 7/8.....		12/31/99	-0-	60,000	-0-	BLB ⁽¹¹⁾⁽¹³⁾	6.160
Series BJ 9/10 ⁽¹⁶⁾	4/27/00		-0-	40,000	-0-	Trinity ⁽¹⁸⁾	6.695
Series BS ⁽¹⁷⁾	4/27/00		-0-	26,500	-0-	Trinity ⁽¹⁸⁾	6.695
Sub-total.....			-0-	\$ 192,313	-0-		
Veterans G.O. Bond Recycling Subaccounts							
1984 Code.....		12/31/99	-0-	853	-0-	Soc Gen ^(2,3)	5.710
		12/31/99	-0-	2	-0-	SMIF	Variable
Series BC/BF.....		12/31/99	-0-	12,401	-0-	SMIF	Variable
	3/1/00		-0-	10,000	-0-	SMIF	Variable
Series BM/BN.....		12/31/99	\$ 9,054	-0-	-0-	WestLB ⁽¹⁰⁾⁽¹³⁾	5.380
	3/1/00		5,000	-0-	-0-	WestLB ⁽¹⁰⁾⁽¹³⁾	5.380
Unrestricted.....		12/31/99	51,487	-0-	-0-	Trinity ⁽⁵⁾	5.702
		12/31/99	33,000	-0-	-0-	SMIF	Variable
	3/1/00		21,000	-0-	-0-	SMIF	Variable
	3/29/00		50,000	-0-	-0-	Trinity ⁽¹²⁾	7.055
Sub-total.....			\$ 169,541	\$ 23,256	-0-		
Veterans G.O. Bonds Short-Term							
Series BJ 5/6 ⁽⁴⁾		12/31/99	-0-	171,500	-0-	BLB ⁽⁹⁾⁽¹³⁾	5.163
Sub-total.....			-0-	\$ 171,500	-0-		
Total Veterans G.O. Bonds.....			\$ 169,541	\$ 387,069	-0-		
Revenue Bonds Proceeds Subaccounts							
1997 A/B and 1998 A.....		12/31/99	-0-	-0-	\$ 2,000	SMIF	Variable
1999 A/B.....		12/31/99	3,173	-0-	-0-	SMIF	Variable
2000 A/B/C ⁽¹⁹⁾	3/29/00		7,614	-0-	-0-	SMIF	Variable
Sub-total.....			\$ 10,787	-0-	\$ 2,000		
Revenue Bonds Recycling Subaccounts							
Section 143.....		12/31/99	-0-	-0-	146,455	Soc Gen ^(2,7)	5.730
		12/31/99	-0-	-0-	4,295	SMIF	Variable
1991 A Recycling.....		12/31/99	385	-0-	-0-	SMIF	Variable
	3/1/00		7,000	-0-	-0-	BLB ⁽¹⁴⁾⁽¹³⁾	6.06
1999 A/B.....	3/1/00		5,000	-0-	-0-	BLB ⁽¹⁵⁾⁽¹³⁾	5.30
2000 A/B/C ⁽¹⁹⁾	3/29/00		-0-	-0-	-0-	WestLB ⁽²⁰⁾⁽¹³⁾	6.460
Sub-total.....			\$ 12,385	-0-	\$ 150,750		
Revenue Bonds Short-Term							
1997 Series C ⁽⁴⁾		12/31/99	-0-	-0-	93,000	NatWest ⁽⁸⁾	4.980
Sub-total.....			-0-	-0-	\$ 93,000		
Total Revenue Bonds.....			\$ 23,172	-0-	\$ 245,750		
Grand Total.....			\$ 192,713	\$ 387,069	\$ 245,750		

Footnotes are on the following page.

- (1) 000's omitted.
- (2) On February 1, 1999, Moody's announced that it had placed under review for possible downgrade certain ratings of Societe Generale, including its long-term ratings (senior debts and deposits, currently rated at Aa3 by Moody's) and its bank financial strength rating (currently rated at B by Moody's).
- (3) Investment agreement maturing December 1, 2000 with Societe Generale.
- (4) Proceeds will become available only with respect to those bonds on which the interest rate has been adjusted to fixed interest rates to maturity.
- (5) Investment agreement maturing April 1, 2001 with Trinity Plus Funding Company, LLC ("Trinity"). Under certain circumstances, Trinity will have the benefits of a letter of credit from General Electric Capital Corporation ("GE Capital") and of a revolving liquidity facility under which GE Capital is a lender (there can be additional lenders under the liquidity facility). However, the aggregate of the amounts available under the letter of credit and the liquidity facility may be significantly less than Trinity's obligations under its investment agreements.
- (6) Investment agreement maturing June 1, 2001 with Trinity. Under certain circumstances, Trinity will have the benefits of a letter of credit and a revolving liquidity facility from GE Capital as described in footnote (5).
- (7) Investment agreement maturing December 1, 2001 with Societe Generale.
- (8) Investment agreement maturing December 1, 2001 with National Westminster Bank Plc.
- (9) Investment agreement maturing June 1, 2001 with Bayerische Landesbank Girozentrale.
- (10) Investment agreement maturing December 1, 2028 with Westdeutsche Landesbank Girozentrale.
- (11) Investment agreement maturing December 1, 2001 with Bayerische Landesbank Girozentrale.
- (12) Investment agreement maturing June 1, 2005 with Trinity Plus Funding Company, LLC. Under certain circumstances, Trinity will have the benefits of a letter of credit and a revolving liquidity facility from GE Capital as described in footnote (5).
- (13) On December 7, 1999, S&P announced that it had changed its rating outlook for these banks from stable to negative.
- (14) Investment agreement maturing December 1, 2009 with Bayerische Landesbank Girozentrale.
- (15) Investment agreement maturing December 1, 2028 with Bayerische Landesbank Girozentrale.
- (16) Currently bearing interest at short-term rates. Expected to be remarketed at fixed rates to maturity on or about April 27, 2000 as part of the Offered Veterans G.O. Bonds.
- (17) Offered Veterans G.O. Bonds.
- (18) Expected investment agreement maturing June 1, 2002 with Trinity Plus Funding Company, LLC. Under certain circumstances, Trinity will have the benefits of a letter of credit and a revolving liquidity facility from GE Capital as described in footnote (5).
- (19) The Department's Home Purchase Revenue Bonds, 2000 Series A, 2000 Series B and 2000 Series C, are expected to be issued on or about March 29, 2000, May 3, 2000, and July 6, 2000, respectively.
- (20) Investment agreement maturing June 1, 2010 with Westdeutsche Landesbank Girozentrale.

Cancellations and Delinquencies

Set forth in the table below is a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period.

	<u>1994⁽¹⁾</u>	<u>1995⁽¹⁾</u>	<u>1996⁽¹⁾</u>	<u>1997⁽¹⁾</u>	<u>1998⁽¹⁾</u>	<u>1999⁽¹⁾</u>	<u>2000⁽²⁾</u>
Percentage of Number of Contracts of Purchase Delinquent⁽³⁾							
30-67 days	0.99%	1.45%	2.90%	1.65%	0.78%	0.87%	0.89%
68+ days	4.24%	3.12%	2.50%	3.22%	1.99%	1.34%	1.46%
Cancelled Contracts and Bankruptcies ⁽⁴⁾	0.38%	0.64%	0.82%	0.94%	0.82%	0.55%	0.37%
Repossessed Contracts.....	0.35%	0.64%	1.07%	0.92%	0.67%	0.39%	0.21%
USDVA Guaranteed Loans⁽⁵⁾							
Percentages in U.S.							
Delinquent							
30-60 days	4.07%	4.14%	4.59%	4.54%	4.45%	4.35%	4.59%
60+ days	2.25%	2.21%	2.20%	2.21%	2.35%	2.26%	2.47%
Foreclosures in inventory.....	1.44%	1.26%	1.54%	1.81%	1.77%	1.82%	1.54%
Percentages in California							
Delinquent							
30-60 days	3.42%	4.03%	4.23%	4.30%	4.28%	4.13%	4.43%
60+ days	2.36%	2.53%	2.36%	2.52%	2.61%	2.45%	2.67%
Foreclosures in inventory.....	2.28%	2.31%	3.18%	3.54%	2.92%	2.28%	1.62%

(1) As of June 18 for Department's and as of June 30 for USDVA data.

(2) As of December 31, 1999 for Department's and as of September 30, 1999 for USDVA data.

(3) Time periods conform to Department's record-keeping system.

(4) Bankruptcies are included in cancelled Contracts statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.

(5) Source: National Delinquency Survey published by the Mortgage Bankers Association of America.

Veterans G.O. Bonds and Revenue Bonds

The chart below sets forth certain information regarding Veterans G.O. Bonds and Revenue Bonds, including those expected to be redeemed as a result of the issuance of the Offered Revenue Bonds and 2000 Veterans G.O. Bonds.

Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

Series	Bonds Outstanding as of 12/31/99	Bonds Expected to be Outstanding as of 7/6/00	Final Maturity or Mandatory Tender Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bond Subject to Special Redemption
Veterans G.O. Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
QQ.....	\$ 4,800,000	--					
AD.....	42,600,000	-- (5)					
AE.....	22,720,000	-- (6)					
AF.....	34,080,000	-- (6)					
AG.....	42,600,000	-- (7)					
Sub-total.....	\$ 146,800,000	--					
Veterans G.O. Bonds Issued to Refund Bonds Issued Prior to the Mortgage Subsidy Bond Tax Act of 1980							
BM.....	\$ 66,600,000	\$ 66,600,000	December 1, 2025	-- (1)	-- (1)	5.450%	Excess Revenues/Unexpended
BN2-4.....	91,065,000	91,065,000	December 1, 2028	-- (1)	-- (1)	5.450%	Excess Revenues/Unexpended
Sub-total.....	\$ 157,665,000	\$ 157,665,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1954 Code							
AH.....	\$ 49,000,000	\$ 49,000,000	August 1, 2006	August 1, 2001	100%	10.000%	No
AK.....	12,000,000	10,500,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AL.....	38,000,000	32,000,000	April 1, 2007	Non-callable	N.A.	N.A.	No
AM.....	53,000,000	53,000,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AN/AP.....	90,000,000	82,500,000	April 1, 2009	Non-callable	N.A.	N.A.	No
AQ.....	82,500,000	82,500,000	October 1, 2008	Non-callable	N.A.	N.A.	No
AR.....	37,500,000	37,500,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AS.....	41,500,000	41,500,000	October 1, 2009	Non-callable	N.A.	N.A.	No
AT.....	194,155,000	180,050,000	February 1, 2010	Non-callable	N.A.	N.A.	No
AU.....	122,230,000	122,230,000	October 1, 2010	Non-callable	N.A.	N.A.	No
AV.....	83,670,000	83,670,000	October 1, 2010	Non-callable	N.A.	N.A.	No
Sub-total.....	\$ 803,555,000	\$ 774,450,000					
Veterans G.O. Bonds Issued as Qualified Veterans Mortgage Bonds under the 1986 Code							
BC/BF ⁽¹⁾	\$ 320,745,000	\$ 319,645,000	February 1, 2027	1 st of Any Month	100%	6.550%	Allocated Prepayments ⁽²⁾
BG/BH.....	586,355,000	586,355,000	December 1, 2032	-- (4)	-- (4)	5.600% ⁽⁴⁾	Excess Revenues/Unexpended
BJ3/4.....	40,000,000	--					
BJ5/6.....	171,500,000	171,500,000	June 1, 2001	June 1, 2000	--	--	Unexpended
BJ7/8.....	60,000,000	60,000,000	December 1, 2032	-- (8)	100%	3.600%	Excess Revenues/Unexpended
BJ9/10.....	--	40,000,000	December 1, 2032	-- (9)	-- (8)	6.200% ⁽⁸⁾	Excess Revenues/Unexpended
BK/BL.....	255,615,000	255,615,000	December 1, 2012	-- (4)	-- (9)	6.050% ⁽⁹⁾	Excess Revenues/Unexpended
BP/BN ⁽¹⁾⁽⁴⁾	14,000,000	14,000,000	December 1, 2026	-- (1)	-- (4)	5.300% ⁽⁴⁾	Excess Revenues/Unexpended
BQ/BR.....	80,000,000	80,000,000	December 1, 2029	June 1, 2004	101%	5.500% ⁽¹⁾	Excess Revenues/Unexpended
BS.....	--	26,500,000	December 1, 2008	Non-callable	N/A	5.300%	Excess Revenues/Unexpended
Sub-total.....	\$ 1,528,215,000	\$ 1,553,615,000					
TOTAL VETERANS G.O. BONDS.....	\$ 2,636,235,000	\$ 2,485,730,000					

Series	Bonds Outstanding as of 12/31/99	Bonds Expected to be Outstanding as of 7/6/00*	Final Maturity or Mandatory Tender Date of Series	Next Optional Call Date	Call Price on Such Date	Maximum Coupon Subject to Optional Call	Bond Subject to Special Redemption
Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code							
1997 A/B	\$ 20,500,000	\$ 20,500,000	December 1, 2028	December 1, 2008	101%	5.500%	Excess Revenues/Unexpended
1997 C	100,000,000	100,000,000	December 1, 2001	August 1, 2000	100%	3.650%	Unexpended
1998 A	134,900,000	130,705,000	December 1, 2019	December 1, 2008	101%	5.450%	Excess Revenues/Unexpended
Sub-total	\$ 255,400,000	\$ 251,205,000					
Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980							
1999 A	\$ 54,170,000	\$ 54,170,000	December 1, 2027	June 1, 2004	101%	5.200%	Excess Revenues/Unexpended
1999 B	86,085,000	86,085,000	December 1, 2028	June 1, 2004	101%	5.200%	Excess Revenues/Unexpended
2000 A	--	54,000,000	December 1, 2004	June 1, 2002	100%	4.750%	Excess Revenues/Unexpended
2000 B	--	63,200,000	December 1, 2006	June 1, 2002	100%	5.000%	Excess Revenues/Unexpended
2000 C	--	42,600,000	December 1, 2027	June 1, 2005	101%	6.150%	Excess Revenues/Unexpended
Sub-total	\$ 140,255,000	\$ 300,055,000					
TOTAL REVENUE BONDS							
	\$ 395,655,000	\$ 551,260,000					
TOTAL ALL BONDS...							
	\$ 3,031,890,000	\$ 3,036,990,000					

- (1) The Series BM Bonds and Series BN Bonds maturing on and before December 1, 2004 are subject to optional redemption at par on and after June 1, 2000. The remaining Series BM Bonds and Series BN Bonds and all of the Series BP Bonds are subject to optional redemption on and after December 1, 2003, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2004.
- (2) Series BC/BF includes Series BC, Series BD, Series BE and Series BF.
- (3) Subject to redemption at par from a portion of prepayments on all Contracts of Purchase as allocated to Series BC/BF is now subject to optional redemption outstanding bonds (including Veterans G.O. Bonds and Revenue Bonds) of Series to all outstanding bonds. Series BC/BF is now subject to optional redemption at par.
- (4) Except as described in the next sentence, the Series BG Bonds, Series BH Bonds, and Series BL Bonds are subject to optional redemption on and after December 1, 2008, initially at 101% of the principal amount thereof, declining to par on December 1, 2009. The Series BH Bonds maturing on December 1, 2018, December 1, 2024, and December 1, 2032 are subject to optional redemption on and after December 1, 2003 at 102% of the principal amount thereof, declining to 101% of the principal amount thereof on and after December 1, 2004, and declining further to par on December 1, 2005. The Series BK Bonds are not subject to optional redemption.
- (5) Reduction in an amount reflects those Veterans G.O. Bonds expected to be retired following expected sale and delivery of the Department's Home Purchase Revenue Bonds, 2000 Series A on or about March 29, 2000.
- (6) Reduction in an amount reflects those Veterans G.O. Bonds expected to be retired following expected sale and delivery of the Department's Home Purchase Revenue Bonds, 2000 Series B on or about May 3, 2000.
- (7) Reduction in an amount reflects those Veterans G.O. Bonds expected to be retired following expected sale and delivery of the Department's Home Purchase Revenue Bonds, 2000 Series C on or about July 6, 2000.
- (8) The BJ-7/8 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on December 1, 2009, initially at 101% of the principal amount thereof, declining to par on and after December 1, 2010. The BJ-7/8 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on December 1, 2005, initially at 102% of the principal amount thereof, declining to par on and after December 1, 2007.
- (9) The BJ-9/10 Serial Bonds maturing on December 1, 2010 through and including December 1, 2016 are subject to optional redemption on April 27, 2010, initially at 101% of the principal amount thereof, declining to par on and after April 27, 2011. The BJ-9/10 Term Bonds maturing on December 1, 2018, December 1, 2024 and December 1, 2032 are subject to optional redemption on April 27, 2006, initially at 102% of the principal amount thereof, declining to par on and after April 27, 2008.

Additional Investments

In addition to the investments described above under "Contracts of Purchase--Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments," the following investments have been made or will be made with respect to moneys in the 1943 Fund and the Bond Reserve Account which secures the Revenue Bonds:

<u>Fund or Account Designation⁽¹⁾</u>	<u>Amount</u>	<u>Type of Investment</u>	<u>Investment Provider</u>	<u>Investment Maturity Date</u>	<u>Investment (%)</u>
1997/1998 Bond Reserve Subaccount.....	\$5,251,650	investment agreement	Societe Generale ⁽³⁾	12/1/28	5.75
	\$7,001,992 ⁽²⁾	U.S. Treasury Bond	N.A.	5/15/05	6.50
1999 Bond Reserve Subaccount.....	\$9,817,850	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/28	5.38
2000 Bond Reserve Subaccount.....	\$10,186,000	investment agreement	Trinity Plus Funding Company, LLC	12/1/27	6.895
1997/1998 Revenue Bond Series Revenue Subaccount and 1997/1998 Revenue Bond Series Restricted Recoveries Subaccount.....	variable	investment agreement	Societe Generale ⁽³⁾	12/1/28	5.91
BG, BH, BK, BL G.O. Bond Series Revenue Subaccount and BG, BH, BK, BL G.O. Bonds Series Recycling Subaccount.....	variable ⁽⁴⁾	investment agreement	Societe Generale ⁽³⁾	12/1/32	5.91
BM, BN2-4 G.O. Bond Series Revenue Subaccount and BM, BN2-4 Bond Series Recycling Subaccount.....	variable ⁽⁵⁾	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/28	5.38
BP, BN-1 G.O. Bond Series Revenue Subaccount and BP, BN-1 Bond Series Recycling Subaccount.....	variable ⁽⁵⁾	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/28	5.38
1999 A/B Revenue Bond Series Revenue Subaccount and 1999 A/B Revenue Bond Series Recycling Subaccount.....	variable ⁽⁶⁾	investment agreement	Bayerische Landesbank Girozentrale ⁽⁹⁾	12/1/28	5.30
BQ/BR G.O. Bond Series Revenue Subaccount and BQ/BR G.O. Bond Series Recycling Subaccount.....	variable ⁽⁷⁾	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/29	5.37
BJ 7/8 G.O. Bond Series Revenue Subaccount and BJ 7/8 G.O. Bond Series Recycling Subaccount.....	variable ⁽⁸⁾	investment agreement	Bayerische Landesbank Girozentrale ⁽⁹⁾	12/1/32 ⁽⁸⁾	6.06
1991 A Revenue Bond Series Revenue Subaccount and 1991 A Revenue Bond Series Recycling Subaccount.....	variable ⁽⁸⁾	investment agreement	Bayerische Landesbank Girozentrale ⁽⁹⁾	12/1/32 ⁽⁸⁾	6.06
2000 A/B/C Revenue Bond Series Revenue Subaccount and 2000 A/B/C Revenue Bond Series Recycling Subaccount.....	variable ⁽¹⁰⁾	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/27 ⁽¹⁰⁾	6.46
BJ 9/10 G.O. Bond Series Revenue Subaccount and BJ 9/10 G.O. Bond Series Recycling Subaccount.....	variable ⁽¹¹⁾	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/32 ⁽¹¹⁾	6.46
BS G.O. Bond Series Revenue Subaccount.....	variable ⁽¹¹⁾	investment agreement	Westdeutsche Landesbank Girozentrale ⁽⁹⁾	12/1/32 ⁽¹¹⁾	6.46

(1) Accounts are established in the resolutions authorizing the issuance of Revenue Bonds.

(2) At cost.

(3) On February 1, 1999, Moody's announced that it had placed under review for possible downgrade certain ratings of Societe Generale, including its long-term ratings (senior debts and deposits, currently rated at Aa3 by Moody's) and its bank financial strength rating (currently rated at B by Moody's).

(4) Maximum permitted amount on deposit under investment agreement at any one time is \$250,000,000.

(5) Maximum permitted amount on deposit under investment agreement for all subaccounts is \$50,000,000.

(6) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$75,000,000.

(7) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$35,000,000.

(8) Maximum permitted amount on deposit under investment agreement for all subaccounts is \$25,000,000.

Investment maturity date for the recycling subaccounts is December 1, 2009.

- (9) On December 7, 1999, S&P announced that it had revised its rating outlook for these banks from stable to negative.
- (10) Maximum permitted amount on deposit under investment agreement for both subaccounts is \$20,000,000.
Investment maturity date for the recycling subaccount is June 1, 2010.
- (11) Maximum permitted amount on deposit under investment agreement for all three subaccounts is \$20,000,000.
Investment maturity date for BJ-9/10 G.O. Bond Series Recycling Subaccount is June 1, 2010.

APPENDIX C

BOOK-ENTRY SYSTEM

The information concerning The Depository Trust Company ("DTC") and DTC's book-entry system has been obtained from sources that the State Treasurer believes to be reliable, but the Treasurer and the Underwriters take no responsibility for the accuracy or completeness thereof.

DTC, New York, New York, will act as securities depository for the Offered Veterans G.O. Bonds. The Offered Veterans G.O. Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in accounts of Participants, thereby eliminating the need for physical movement of securities certificates. Direct Participants (the "Direct Participants") include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as banks, securities brokers and dealers and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The Rules applicable to DTC and its Participants and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of the Offered Veterans G.O. Bonds under the DTC System must be made by or through Direct Participants, which will receive a credit for the Offered Veterans G.O. Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Veterans G.O. Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Veterans G.O. Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Offered Veterans G.O. Bonds, except in the event that use of the book-entry system for the Offered Veterans G.O. Bonds is discontinued.

To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. (or such other name as may be requested by an authorized representative of DTC). The deposit of Offered Veterans G.O. Bonds with DTC and their registration in the name of Cede & Co. do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Veterans G.O. Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Veterans G.O. Bonds are credited, which may or may not be the Beneficial Owners. The Participants and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Participants or the persons for whom they act as nominees with respect to the Offered Veterans G.O. Bonds.

Beneficial Owners of the Offered Veterans G.O. Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Offered Veterans G.O. Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Offered Veterans G.O. Bond documents. Beneficial Owners of the Offered Veterans G.O. Bonds may wish to ascertain that the nominee holding the Offered Veterans G.O. Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to Cede & Co. If less than all of a maturity of a Series of the Offered Veterans G.O. Bonds is being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to Offered Veterans G.O. Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Veterans G.O. Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Without limiting the generality of the foregoing, the State Treasurer and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Offered Veterans G.O. Bonds.

Principal, premium and interest payments on the Offered Veterans G.O. Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will

be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Participant and not of DTC (nor its nominee) or the State Treasurer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

The State Treasurer and the Underwriters cannot and do not give any assurances that DTC, Participants or others will distribute payments with respect to the Offered Veterans G.O. Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

The State Treasurer may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered. DTC may discontinue providing its services as securities depository with respect to the Offered Veterans G.O. Bonds at any time by giving reasonable notice to the State Treasurer.

Under such circumstances, in the event that a successor securities depository is not obtained, bond certificates are required to be printed and delivered.

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APPENDIX D

SUMMARY OF CONTINUING DISCLOSURE CERTIFICATES

STATE TREASURER'S DISCLOSURE CERTIFICATES

The State Treasurer, on behalf of the State, executed Continuing Disclosure Certificates (the "Treasurer's Disclosure Certificates") for the Offered Veterans G.O. Bonds. The following is a summary of the provisions of the Treasurer's Disclosure Certificates. Such summary is qualified by reference to the complete Treasurer's Disclosure Certificates, which are available from the Office of the State Treasurer.

Definitions

Pursuant to the Treasurer's Disclosure Certificates, the following definitions will apply:

"Annual Report" shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, the Treasurer's Disclosure Certificates.

"Beneficial Owner" shall mean any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any applicable Offered Veterans G.O. Bonds (including persons holding applicable Offered Veterans G.O. Bonds through nominees, depositories or other intermediaries).

"Dissemination Agent" shall mean the State Treasurer, acting in its capacity as Dissemination Agent under the Treasurer's Disclosure Certificates, or any successor Dissemination Agent designated in writing by the State Treasurer.

"Holder" shall mean any person listed on the registration books of the State Treasurer as the registered owner of any applicable Offered Veterans G.O. Bonds.

"Listed Events" shall mean any of the events listed below under "Reporting of Significant Events."

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository certified by the Securities and Exchange Commission to be the recipient of information of the nature of the Annual Reports required by the Treasurer's Disclosure Certificates.

"Official Statement" shall mean the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

"Repository" shall mean each National Repository and the State Repository.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the Annual Reports or reports of material events required by the Treasurer's Disclosure Certificates and recognized as such by the Securities and Exchange Commission. As of the date of this Official Statement, there is no State Repository.

Annual Reports

The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the applicable Offered Veterans G.O. Bonds are outstanding, commencing with the report for the 1999-2000 Fiscal Year, provide an Annual Report consistent with the requirements of the applicable Treasurer's Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery.

If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

The Annual Report shall contain or include by reference the following:

(1) The audited General Purpose Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to the Treasurer's Disclosure Certificates, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the applicable final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(2) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations, including updating the following tables which appear under the caption

APPENDIX A – "THE STATE OF CALIFORNIA – Current State Budget" in the applicable Official Statement:

Table Entitled

Summary of State Revenues and Expenditures
Revenue and Expenditure Assumptions

(3) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A – "THE STATE OF CALIFORNIA – State Indebtedness" in the Official Statement.

Table Entitled

Authorized and Outstanding General Obligation Bonds

Outstanding State Debt

Schedule of Debt Service Requirements for General Fund
General Obligation Bonds

Schedule of Debt Service Requirements for
Enterprise Fund General Obligation Bonds

Schedule of Debt Service Requirements for
Lease-Purchase Debt

State Public Works Board and
Other Lease-Purchase Financing

State Agency Revenue Bonds and
Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents which have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Reporting of Significant Events

The State Treasurer, on behalf of the State shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the applicable Offered Veterans G.O. Bonds (hereafter referred to as a "Listed Event"), if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;
7. adverse tax opinions or events affecting the tax-exempt status of the applicable Offered Veterans G.O. Bonds;
8. unscheduled draws on debt service reserves reflecting financial difficulties;
9. unscheduled draws on credit enhancements reflecting financial difficulties;
10. substitution of credit or liquidity providers, or their failure to perform; or
11. release, substitution or sale of property securing repayment of the applicable Offered Veterans G.O. Bonds.

The State Treasurer shall timely file a notice of each such occurrence, if it is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository. The State notes that items 8, 9, 10 and 11 above are not applicable to the Offered Veterans G.O. Bonds.

Other Provisions

Termination of Reporting Obligation. The State's obligations under the Treasurer's Disclosure Certificates shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the applicable outstanding Offered Veterans G.O. Bonds.

Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under the Treasurer's Disclosure Certificates, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Amendment; Waiver. Notwithstanding any other provision of the Treasurer's Disclosure Certificates, the State Treasurer may amend or waive any provision of the Treasurer's Disclosure Certificates, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of the Treasurer's Disclosure Certificates dealing with the timing or content of the Annual Report or the giving of notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change

in legal requirements, change in law or change in the identity, nature or status of an obligated person with respect to the applicable Offered Veterans G.O. Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the applicable Offered Veterans G.O. Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of sixty percent (60%) of the applicable Offered Veterans G.O. Bonds, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the applicable Offered Veterans G.O. Bonds.

Additional Information. Nothing in either Treasurer's Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in the Treasurer's Disclosure Certificates or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Treasurer's Disclosure Certificates. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by the Treasurer's Disclosure Certificates, the State Treasurer shall not have any obligation to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Beneficiaries. The Treasurer's Disclosure Certificates shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the applicable Offered Veterans G.O. Bonds, and shall create no rights in any other person or entity (except the right of any Bondholder or Beneficial Owner to enforce the provisions of the Treasurer's Disclosure Certificates on behalf of the Bondholders). The Treasurer's Disclosure Certificates are not intended to create any monetary rights on behalf of any person based upon the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with the Treasurer's Disclosure Certificates shall be an action to compel performance of any act required thereunder.

DEPARTMENT'S DISCLOSURE CERTIFICATES

The Secretary of Veterans Affairs (the "Secretary"), on behalf of the Department, executed Continuing Disclosure Certificates (the "Department's Disclosure Certificates") for the Offered Veterans G.O. Bonds. The following is a summary of the Department's Disclosure Certificates. Such summary is qualified by reference to the complete Department's Disclosure Certificates, which are available from the Department.

Certain Definitions

Defined terms used in the Department's Disclosure Certificates and not otherwise defined therein have the meanings set forth elsewhere in this Official Statement.

"Beneficial Owner" means a Beneficial Owner of Subject Bonds, as determined pursuant to the Rule.

"Bonds" means, at any time, all of the State's then Outstanding Offered Veterans G.O. Bonds, collectively.

"Fiscal Year" means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of the Department's Disclosure Certificates, the Department's Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

"Holders" means the registered owners of the Subject Bonds.

"MSRB" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, as amended.

"Notice" means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

"Notice Address" means with respect to the Department:

State of California Department of Veterans Affairs
1227 O Street
Sacramento, CA 95814
Attention: Bond Finance Division

"NRMSIR" means, at any time, a then-existing nationally recognized municipal securities information repository, as recognized from time to time by the SEC for the purposes referred to in the Rule.

"Official Statement" means the Official Statement relating to the original issuance of the Offered Veterans G.O. Bonds.

"Rule" means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, § 240.15c2-12), as in effect on the date of the Department's Disclosure Certificates, including any official interpretations thereof.

"SEC" means the United States Securities and Exchange Commission.

"Securities Counsel" means legal counsel expert in federal securities laws.

"SID" means, at any time, a then-existing state information depository, if any, as operated or designated as such by or on behalf of the State and recognized by the SEC for the purposes referred to in the Rule.*

"Subject Bonds" means the Offered Veterans G.O. Bonds and those Veterans G.O. Bonds subject to the same Department's Disclosure Certificate.

Provision of Annual Financial Information

The Department will, not later than the first day of the tenth calendar month after the end of each of the Department's Fiscal Years, commencing with the report for the 1999-2000 Fiscal Year, provide to the State Treasurer and to each NRMSIR and the SID the Annual Financial Information (as described hereinbelow). The audited financial statements of the Department may be submitted separately from the balance of the Annual Financial Information, and later than the date required for the filing of the Annual Financial Information if not available by that date.

The Department's Disclosure Certificates require the Department to provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to each NRMSIR and the SID on or before the date described in the first paragraph under this heading, to the SID, to the State Treasurer, and to either (i) each NRMSIR or (ii) the MSRB.

Content of Annual Financial Information

The Department's Annual Financial Information shall contain or include by reference the following:

(a) financial information or operating data of the types included in Exhibit 2 to APPENDIX B of the Official Statement entitled "Certain Department Financial Information and Operating Data"; and

(b) the audited financial statements of the 1943 Fund for the Fiscal Year ended on the previous June 30, prepared in accordance with generally accepted accounting principles established by the Financial Accounting Standards Board, if available, or unaudited financial statements for such Fiscal Year.

* As of the date of this Official Statement, there is no SID.

If not provided as part of the Annual Financial Information by the date required (as described above under "Provision of Annual Financial Information"), the Department shall provide audited financial statements, when and if available, to the State Treasurer and to each NRMSIR and the SID.

Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Department or related public entities, which have been submitted to each NRMSIR and the SID or the SEC. (If such document is an official statement, it must also be available from the MSRB.) Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Additional Information

Nothing in the Department's Disclosure Certificates will be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in such Department's Disclosure Certificates or any other means of communication, or including any other information in any Annual Financial Information, in addition to that which is required by the Department's Disclosure Certificates. If the Department chooses to include any information in any Annual Financial Information in addition to that which is specifically required by the Department's Disclosure Certificates, the Department will have no obligation under the Department's Disclosure Certificates to update such information or include it in any future Annual Financial Information.

Amendment of Department's Disclosure Certificate

The Department's Disclosure Certificates may be amended and any provision of the Department's Disclosure Certificates be waived, without the consent of the Holders or Beneficial Owners, except as described in clause 4 (ii) below, under the following conditions: (1) such amendment or waiver is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature or status of the Department or the type of business conducted thereby, (2) the Department's Disclosure Certificates as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have obtained an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as bond counsel), acceptable to the Department, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners, or (ii) the applicable Holders consent to the amendment to or waiver of such Department's Disclosure Certificates, and (5) the Department shall have delivered copies of such amendment or waiver to the SID, to the State Treasurer, and to either each NRMSIR or the MSRB.

In addition to the foregoing, the Department may amend the Department's Disclosure Certificates, and any provision of the Department's Disclosure Certificates may be waived, if the Department shall have received an opinion of Securities Counsel, addressed to the Department and the State Treasurer, to the effect that the adoption and the terms of the amendment or waiver would not, in and of themselves, cause the undertakings in such Department's Disclosure Certificates to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

Benefit; Enforcement

The provisions of the Department's Disclosure Certificates will inure solely to the benefit of the Holders and Beneficial Owners from time to time.

Except as described in this paragraph, the provisions of the Department's Disclosure Certificates will create no rights in any other person or entity. The obligation of the Department to comply with the provisions of the Department's Disclosure Certificates are enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data, and notices, by any Beneficial Owner of outstanding Subject Bonds, or (ii) in the case of challenges to the adequacy of the financial statements, financial information, and operating data so provided, by the Holders of not less than twenty-five percent (25%) in aggregate principal amount of the Subject Bonds at the time Outstanding.

The right to enforce the provisions of the Department's Disclosure Certificates is limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under the Department's Disclosure Certificates. Any failure by the Department to perform in accordance with the Department's Disclosure Certificates will not constitute a default under the Subject Bonds, and the rights and remedies provided by the Subject Bonds upon the occurrence of a default will not apply to any such failure.

Termination of Reporting Obligation

The Department's obligations under the Department's Disclosure Certificates with respect to the Subject Bonds terminate upon the legal defeasance, prior redemption, or payment in full of all of such Subject Bonds. The Department shall give notice of any such termination to the SID and to either each NRMSIR or the MSRB.

The Department's Disclosure Certificates, or any provision thereof, will be null and void to the extent set forth in the opinion of Securities Counsel obtained by the Department and addressed to the Department and the State Treasurer, to the effect that those portions of the Rule which require the provisions of such Department's Disclosure Certificates, or any of such provisions, do not or no longer apply to the applicable Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as will be specified in such opinion, and the Department delivers notice to such effect to the State Treasurer, to the SID and to either each NRMSIR or the MSRB.

Governing Law

The Department's Disclosure Certificates will be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of the Department's Disclosure Certificates will be instituted in a court of competent jurisdiction in the State, *provided that*, to the extent such Department's Disclosure Certificates address matters of federal securities laws, including the Rule, the Department's Disclosure Certificates will be construed in accordance with such federal securities laws and official interpretations thereof.

APPENDIX E

CERTAIN FEDERAL TAX CODE REQUIREMENTS

The Federal Tax Code restricts the issuance of federally tax-exempt bonds to finance mortgage loans for single family housing or to refund such bonds.

Those Federal Tax Code restrictions are not the same for all such tax-exempt bonds. There are three types of such tax-exempt bonds: (i) qualified mortgage bonds, which provide Qualified Mortgage Bond Proceeds, (ii) qualified veterans' mortgage bonds, which provide Qualified Veterans' Mortgage Bond Proceeds, and (iii) pre-Ullman bonds, which provide Unrestricted Moneys. Revenue Bonds may be either qualified mortgage bonds or pre-Ullman Bonds. ("Pre-Ullman bonds" are bonds issued before 1981, or bonds issued to refund such bonds). Veterans G.O. Bonds may be either qualified veterans' mortgage bonds or pre-Ullman bonds. The principal Federal Tax Code restrictions relate to: (i) the use of proceeds of the bond issue, (ii) the yield on the financed mortgage loans and from certain non-mortgage investments related to the issue, (iii) for qualified mortgage bonds and qualified veterans' mortgage bonds, loan eligibility requirements, (iv) for qualified mortgage bonds, the availability of proceeds of the issue for financing housing located in "targeted areas," and (v) certain matters relating to the issue itself.

See "TAX MATTERS" for information regarding the requirements applicable to the Offered Veterans G.O. Bonds.

Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Federal Tax Code on Qualified Mortgage Bond Proceeds and Qualified Veterans' Mortgage Bond Proceeds

Qualified Mortgage Bond Proceeds

The Federal Tax Code contains the following loan eligibility requirements with respect to Qualified Mortgage Bond Proceeds, except that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Code – Recapture Provision" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes. None of those requirements applies to pre-Ullman bonds or qualified veterans' mortgage bonds.

Residence Requirement. The Federal Tax Code requires that each of the premises financed with the lendable proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by

the Department establish procedures to be followed in connection with Contracts of Purchase which finance the acquisition of single family homes in order to assure that interest paid on the qualified mortgage bonds not be included in gross income for federal income tax purposes under the Federal Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase to finance home improvement loans in order to assure that interest paid on the qualified mortgage bonds is not included in gross income for federal income tax purposes under the Federal Tax Code (the "Home Improvement Program Documents", together with the Single Family Program Documents, the "Program Documents"). In connection with the financing of a Contract of Purchase, the Program Documents require that each veteran submit an affidavit stating such person's intention to occupy the premises as his principal residence within 60 days after closing of the Contract of Purchase.

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. This limitation, however, does not apply to the mortgagor's interest in the residence being financed or to certain residences in certain Presidentially-declared disaster areas; and all financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement. Veterans subject to this requirement are required to provide federal income tax returns for the previous three years or other appropriate certifications to allow verification that no deductions or other entries have been made that would indicate any such ownership interest.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan. The Program Documents state that the Department will verify compliance with the new mortgage requirement by requiring each veteran to certify prior to financing, subject to such exceptions, that no refinancing of a prior mortgage loan is being effected.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90% of the average area purchase price applicable to such residence or 110% of the applicable average area purchase price in the case of residences located in targeted areas or residences in certain Presidentially-declared disaster areas. The Program Documents state that the Department will verify compliance with the purchase price limitations by requiring each veteran and seller of a residence to make certifications regarding the purchase price of such residence.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115% (for mortgage loans made to families with fewer than three members, 100%) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with

respect to targeted area residences and residences in certain Presidentially-declared disaster areas that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140% (for mortgage loans made to families with fewer than three members, 120%) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain “high housing cost areas.” A high housing cost area is a statistical area for which the ratios of the area’s average purchase price for existing and new single family houses to the area’s median income exceed 120% of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120% test. In high housing cost areas, the veteran income limits are increased above 115% (or 100%, as applicable) by one percent for each percentage point (1%) by which the new or existing housing price ratio, whichever is smaller, exceeds 120%. However, the new limit cannot exceed 140% (or 120%, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan may be assumed only if each of the then applicable residence requirements, first-time-homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption. The Contracts of Purchase contain a “due on sale” clause, and the Department will not permit the assumption of a Contract of Purchase unless it has determined that these requirements have been met and has obtained the appropriate certifications.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified mortgage bonds not exceed \$15,000, be made only with respect to an owner-occupied residence, and finance alterations, repairs, and improvements on or in connection with an existing one-to-four-family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property.

General. Qualified mortgage bonds treated under the Federal Tax Code as one bond issue for federal tax purposes (“qualified mortgage issue”) are deemed to meet the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95% or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed. In determining whether 95% or more of the proceeds has been so used, the Federal Tax Code permits the Department to rely on an affidavit of the veteran and of the seller as to the purchase price of a residence and an affidavit of the veteran and an examination of copies of the veteran’s federal income tax returns for the last three years preceding the date the Contract of

Purchase is or was executed even though the relevant information in such affidavits and income tax returns should ultimately prove to be untrue, unless the Department knows or has reason to believe that such information is false.

Qualified Veterans' Mortgage Bond Proceeds

The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans' mortgage bond issue have served on active duty at some time before January 1, 1977 and apply for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established and has covenanted to comply with such requirements.

Generally, only the loan eligibility requirements stated above under "Qualified Mortgage Bond Proceeds – Residence Requirement," "– New Mortgage Requirement" and "– Qualified Home Improvement Loans" (except the \$15,000 maximum loan amount) apply to Qualified Veterans' Mortgage Bond Proceeds.

Other Requirements Imposed by the Federal Tax Code

General. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans' mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance or to refund bonds all of such proceeds of which were used to finance owner-occupied residences and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code." A qualified veterans' mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans and that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under "Loan Eligibility Requirements Imposed by the Federal Tax Code."

Volume Limitation, Targeted Area and Required Reports. The first general requirement of the Federal Tax Code, applicable to qualified mortgage bonds and pre-Ullman bonds, is that the aggregate amount of private activity bonds (exclusive of qualified veterans' mortgage bonds) that may be issued by the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, a separate limit is based on statutory formulae. The second general requirement of the Federal Tax Code applicable to qualified mortgage bonds is that at least 20% of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for

such owner-financing (the “targeted area requirement”). The third general requirement of the Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans’ mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds or qualified veterans mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report.

Yield Limitations and Rebate. The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans’ mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for pre-Ullman bonds), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is to veterans. The Department has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See APPENDIX B – “THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUNDS” and “–THE PROGRAM – Contracts of Purchase” for discussions of provisions of the Veterans Code which affect the Department’s ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision Applicable to Qualified Mortgage Bonds. For certain mortgage loans made after December 31, 1990 from the lendable proceeds of qualified mortgage bonds issued after August 15, 1986, and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the “Recapture Provision”). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the residence (but not in excess of 50% of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the residence were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a \$250,000 de minimis amount. As a result, the Department is required by the Federal Tax Code to redeem the Revenue Bonds which are qualified mortgage bonds from repayments (including prepayments) of principal of certain Contracts of Purchase not later than the close of the semi-annual period after the payment is received.

Compliance. The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

APPENDIX F

LEGAL OPINION OF ATTORNEY GENERAL

**Bill Lockyer
Attorney General
STATE OF CALIFORNIA
1300 I Street, Suite 1101
Sacramento, California 95814**

(Closing Date)

Office of the Treasurer of the State
of California
Sacramento, California

Ladies and Gentlemen:

The undersigned, Attorney General of the State of California, has examined upon request copies of proceedings taken by the State of California (the "State") in connection with the issuance of the State's \$26,500,000 aggregate principal amount Veterans General Obligation Bonds, Series BS (the "Bonds") and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (i) the Veterans Bond Act of 1980 (the "Law"), which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on February 24, 1999, and February 16, 2000.

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolutions.

In connection with the issuance of the Bonds, the undersigned has examined (a) a copy of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, the undersigned is of the opinion that the State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Bonds.

In rendering this opinion, the undersigned is advising you that the enforceability of the Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

The undersigned has examined an executed Bond and, in the opinion of the undersigned, the form of said Bond and its execution are regular and proper.

Very truly yours,

BILL LOCKYER,
ATTORNEY GENERAL

By: _____
Deputy Attorney General

APPENDIX G
LEGAL OPINIONS OF BOND COUNSEL

Hawkins, Delafield & Wood
633 West Fifth Street
Los Angeles, California 90071

December 1, 1999

Office of the Treasurer of the State
of California
Sacramento, California

Ladies and Gentlemen:

We have acted as bond counsel to the State of California, and in such capacity we have examined upon request copies of proceedings taken by the State of California (the "State") in connection with the issuance of \$1,166,970,000 aggregate principal amount of the State's Veterans General Obligation Bonds (the "Bonds"). The Bonds were issued pursuant to (i) the Veterans Bond Acts identified in Schedule A hereto (collectively, the "Law"), which is incorporated by reference, each of which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) the applicable resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on the dates set forth in Schedule B hereto, which is incorporated by reference.

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolutions.

The Department of Veterans Affairs of the State of California (the "Department") has previously issued its Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A (collectively with the Bonds, the "1997 Tax Plan Bonds"). The 1997 Tax Plan Bonds are treated as a single issue for certain federal tax purposes under the Internal

Revenue Code of 1986, as amended (the "Tax Code"). Applicable federal tax law establishes certain requirements that must be met subsequent to the issuance of the 1997 Tax Plan Bonds (including the Bonds) in order that interest on the Bonds not be included in gross income for federal income tax purposes under the Tax Code. The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolutions and in tax certificates and other documents applicable to the issuance of the Bonds (collectively with the Program Documents, the "Documents"), to at all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for federal income tax purposes under the Tax Code. In rendering this opinion, we have relied upon such covenants and have assumed compliance by the State and the Department with the provisions of such Documents.

In connection with rendering this opinion, we have examined (a) copies of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

(i) The State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California is pledged for the punctual payment of the principal of and interest on the Bonds.

(ii) Under existing statutes and court decisions, (a) interest on the Bonds is not included in gross income for federal income tax purposes pursuant to Section 103 of the Tax Code; (b) interest on the Series BG Bonds and Series BK Bonds is not a specific preference item for purposes of calculating the federal alternative minimum tax; however, such interest is included in adjusted current earnings for individuals and corporations for purposes of calculating alternative minimum tax; and (c) interest on the Series BH Bonds, Series BJ Bonds and Series BL Bonds is a specific preference item for purposes of calculating the federal individual or corporate alternative minimum taxes. No opinion as to the exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Documents for which action the Documents require a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.

(iii) Interest on the Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we are advising you that the enforceability of the Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,

[HAWKINS, DELAFIELD & WOOD]

Schedule A

1. \$12,370,000 principal amount of Veterans Bonds, Series BG1, authorized under the Veterans Bond Act of 1996;
2. \$93,000,000 principal amount of Veterans Bonds, Series BG2, authorized under the Veterans Bond Act of 1986;
3. \$206,210,000 principal amount of Veterans Bonds, Series BH1, authorized under the Veterans Bond Act of 1986;
4. \$149,900,000 principal amount of Veterans Bonds, Series BH2, authorized under the Veterans Bond Act of 1988;
5. \$15,265,000 principal amount of Veterans Bonds, Series BH3, authorized under the Veterans Bond Act of 1990;
6. \$23,980,000 principal amount of Veterans Bonds, Series BH4, authorized under the Veterans Bond Act of 1990;
7. \$85,630,000 principal amount of Veterans Bonds, Series BH5, authorized under the Veterans Bond Act of 1996;
8. \$69,610,000 principal amount of Veterans Bonds, Series BJ1, authorized under the Veterans Bond Act of 1988;
9. \$230,390,000 principal amount of Veterans Bonds, Series BJ2, authorized under the Veterans Bond Act of 1990;
10. \$8,500,000 principal amount of Veterans Bonds, Series BK1, authorized under the Veterans Bond Act of 1980;
11. \$500,000 principal amount of Veterans Bonds, Series BK2, authorized under the Veterans Bond Act of 1996; and
12. \$271,615,000 principal amount of Veterans Bonds, Series BL, authorized under the Veterans Bond Act of 1986.

Schedule B

<u>Bond Act</u>	<u>Resolution Number</u>	<u>Date of Adoption of Veterans Finance Committee Resolution</u>
Veterans Bond Act of 1980	I	July 1, 1980
Veterans Bond Act of 1980	II	July 1, 1980
Veterans Bond Act of 1980	XIV	November 24, 1997
Veterans Bond Act of 1980	XV	November 24, 1997
Veterans Bond Act of 1986	I	January 13, 1988
Veterans Bond Act of 1986	II	January 13, 1988
Veterans Bond Act of 1986	III	August 8, 1989
Veterans Bond Act of 1986	IV	August 8, 1989
Veterans Bond Act of 1986	XIII	November 24, 1997
Veterans Bond Act of 1986	XIV	December 22, 1997
Veterans Bond Act of 1988	I	December 11, 1989
Veterans Bond Act of 1988	II	December 11, 1989
Veterans Bond Act of 1988	VII	December 22, 1997
Veterans Bond Act of 1990	I	January 17, 1995
Veterans Bond Act of 1990	III	March 8, 1995
Veterans Bond Act of 1990	IV	November 24, 1997
Veterans Bond Act of 1990	VI	December 22, 1997
Veterans Bond Act of 1996	i	November 24, 1997
Veterans Bond Act of 1996	II	November 24, 1997

Hawkins, Delafield & Wood
633 West Fifth Street
Los Angeles, California 90071

(Closing Date)

Office of the Treasurer of the State
of California
Sacramento, California

Ladies and Gentlemen:

We have acted as bond counsel to the State of California, and in such capacity we have examined upon request copies of proceedings taken by the State of California (the "State") in connection with the issuance of the State's \$40,000,000 aggregate principal amount Veterans General Obligation Bonds, Series BJ 9/10 (the "Series BJ 9/10 Bonds") and the sale of the Series BJ 9/10 Bonds to the purchasers thereof. The Series BJ 9/10 Bonds were issued pursuant to Veterans Bond Acts approved by the electors of the State, Part 3 of Division 4 of Title 2 of the California Government Code, and resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on November 24, 1997 and December 22, 1997.

In addition to the Series BJ 9/10 Bonds, the State has previously issued its Veterans General Obligation Bonds, Series BG, Series BH, Series BJ, Series BK and Series BL and the Department of Veterans Affairs of the State of California (the "Department") has previously issued its Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A (collectively, the "1997/1998 Tax Plan Bonds"). The 1997/1998 Tax Plan Bonds are treated as a single issue for certain federal tax purposes under the Internal Revenue Code of 1986, as amended.

In connection with the remarketing of the Series BJ 9/10 Bonds, we have examined (a) a copy of the Resolutions and the documents authorizing issuance of the other 1997/98 Tax Plan Bonds and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

On December 1, 1999, we rendered to you our opinion as to the treatment of interest on the Series BJ 9/10 Bonds for federal income tax purposes. We are of the opinion that the remarketing of the Series BJ 9/10 Bonds does not, in and of itself, adversely affect the exclusion

of interest on the 1997/1998 Tax Plan Bonds, including the Series BJ 9/10 Bonds, from gross income for federal income tax purposes.

Very truly yours,

[HAWKINS, DELAFIELD & WOOD]

Hawkins, Delafield & Wood
633 West Fifth Street
Los Angeles, California 90071

(Closing Date)

Office of the Treasurer of the State
of California
Sacramento, California

Ladies and Gentlemen:

We have acted as bond counsel to the State of California, and in such capacity we have examined upon request copies of proceedings taken by the State of California (the "State") in connection with the issuance of the State's \$26,500,000 aggregate principal amount Veterans General Obligation Bonds, Series BS (the "Series BS Bonds") and the sale of the Series BS Bonds to the initial purchasers thereof. The Series BS Bonds are issued pursuant to (i) the Veterans Bond Act of 1980 (the "Law"), which was approved by the electors of the State, (ii) Part 3 of Division 4 of Title 2 of the California Government Code, and (iii) resolutions (the "Resolutions") adopted by the Veterans Finance Committee of 1943 on February 24, 1999, and February 16, 2000.

The Series BS Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolutions. The Bonds are subject to redemption prior to maturity in whole or in part as set forth in the Resolutions.

Applicable federal tax law establishes certain requirements that must be met subsequent to the issuance of the Series BS Bonds in order that interest on the Series BS Bonds not be included in gross income for federal income tax purposes under the Internal Revenue Code of 1986, as amended (the "Tax Code"). The Department has adopted documents with respect to its program (the "Program Documents") that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolutions and in tax certificates and other documents applicable to the issuance of the Series BS Bonds (collectively with the Program Documents, the "Documents"), to all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Series BS Bonds shall not be included in gross income for federal income tax purposes under the Tax Code. In rendering this opinion, we have relied upon such covenants and have assumed compliance by the State and the Department with the provisions of such Documents.

In connection with the issuance of the Series BS Bonds, we have examined (a) a copy of the Resolutions, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

i) The State has lawful authority for the issuance of the Series BS Bonds, and the Series BS Bonds constitute the valid and legally binding general obligations of the State payable in accordance with the Law from the General Fund of the State. The full faith and credit of the State of California are pledged for the punctual payment of the principal of and interest on the Series BS Bonds.

ii) Under existing statutes and court decisions, interest on the Series BS Bonds is not included in gross income for federal income tax purposes pursuant to Section 103 of the Tax Code, and interest on the Series BS Bonds is not treated as a preference item for purposes of calculating the alternative minimum tax imposed under the Tax Code with respect to individuals and corporations; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations.

iii) Interest on the Series BS Bonds is exempt from State personal income taxation under present State law.

In rendering this opinion, we are advising you that the enforceability of the Series BS Bonds may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

We have examined an executed Series BS Bond and, in our opinion, the form of said Series BS Bond and its execution are regular and proper.

Very truly yours,

[HAWKINS, DELAFIELD & WOOD]

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